Supreme Court, U.S.
FILED

No. 94- 941518 MAR 14 1995

OFFICE OF THE CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,
Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,
Respondents.

Petition for a Writ of Certiorari to the Supreme Court of Montana

---

PETITION FOR A WRIT OF CERTIORARI

MARK R. KRAVITZ *
JEFFREY R. BABBIN
WIGGIN & DANA
One Century Tower
P.O. Box 1832
New Haven, CT 06508-1832
(203) 498-4400

H. BARTOW FARR, III
FARR & TARANTO
2445 M Street, N.W.
Washington, D.C. 20037
(202) 775-0184

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether Section 2 of the Federal Arbitration Act (9 U.S.C. § 2)—which makes written agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract"—preempts a state law that makes agreements to arbitrate, but not other agreements, unenforceable unless a specific notice of the arbitration agreement is placed on the first page of the contract.

STATEMENTS PURSUANT TO RULES 14.1(b) AND 29.1

Daniel L. Hudson, Deb Hudson, and D&D Subway Corporation are parties to the proceedings in the Montana Eighth Judicial District Court. They were not parties to the appeal in the Supreme Court of Montana and are omitted from the caption in this Court.

Doctor's Associates, Inc., the only corporate petitioner, states that it has no parent company and that it has no subsidiaries (other than wholly-owned subsidiaries).

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
STATEMENTS PURSUANT TO RULES 14.1(b) AND 29.1	ii
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	1
JURISDICTION	1
STATUTORY PROVISIONS INVOLVED	2
STATEMENT	2
A. Introduction	2
B. Factual Background	3
C. Proceedings Below	4
REASONS FOR GRANTING THE WRIT	8
I. THE FEDERAL ARBITRATION ACT PREEMPTS MONTANA'S STATUTORY RESTRICTIONS ON ENFORCEMENT OF ARBITRATION AGREEMENTS	10
II. THE DECISION OF THE MONTANA SUPREME COURT IS IN DIRECT CONFLICT WITH DECISIONS OF THE FIRST, SECOND AND EIGHTH CIRCUITS AND THE HIGHEST COURT OF MISSOURI	15
III. THE MONTANA SUPREME COURT'S DECISION RAISES ISSUES OF NATIONAL IMPORTANCE	20
CONCLUSION	24

TABLE OF AUTHORITIES

CASES — Page

A.C. Beals Co. v. Rhode Island Hosp., 292 A.2d 865 (R.I. 1972) 23
Albright v. Edward D. Jones & Co., 571 N.E.2d 1329 (Ind. Ct. App. 1991), *tranfer denied* (Ind. Feb. 27, 1992), *cert. denied*, 113 S. Ct. 61 (1992) 19
Allied-Bruce Terminix Companies v. Dobson, 115 S. Ct. 834 (1995) ..... *passim*
American Physicians Service Group Inc. v. Port Lavaca Clinic Associates, 843 S.W.2d 675 (Tex. Ct. App. 1992), *writ of error denied* (Tex. Apr. 21, 1993) 19
Bunge Corp. v. Perryville Feed & Produce, Inc., 685 S.W.2d 837 (Mo. 1985) 9, 18, 20
Collins Radio Co. v. Ex-Cell-O Corp., 467 F.2d 995 (8th Cir. 1972) 9, 18, 20
David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London), 923 F.2d 245 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991) 9, 15, 16, 20
Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991) 13
Godwin v. Stanley Smith & Sons, 386 S.E.2d 464 (S.C. Ct. App. 1989) 23
Hefele v. Catanzaro, 727 S.W.2d 475 (Mo. Ct. App. 1987) 23
Joder Bldg. Corp. v. Lewis, 569 A.2d 471 (Vt. 1989) 23
Mastrobuono v. Shearson Lehman Hutton, Inc., 63 U.S.L.W. 4195 (U.S. Mar. 6, 1995) 9, 11, 12, 14, 22
McCarney v. Nearing, Staats, Prelogar & Jones, 866 S.W.2d 881 (Mo. Ct. App. 1993) 23
Moses H. Cone Memorial Hosp. v. Mercury Constr. Co., 460 U.S. 1 (1983) 9, 11, 20
Perry v. Thomas, 482 U.S. 483 (1987) 9, 11, 12, 13
Saturn Distribution Corp. v. Williams, 905 F.2d 719 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990) 13, 19

TABLE OF AUTHORITIES—Continued

Page

Securities Indus. Ass'n v. Connolly, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990) 9, 16, 17, 19, 20
Snap-On Tools Corp. v. Vetter, 838 F. Supp. 468 (D. Mont. 1993) 17
Southland Corp. v. Keating, 465 U.S. 1 (1984) ..... *passim*
Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468 (1989) 7, 9, 14
Webb v. R. Rowland & Co., 800 F.2d 803 (8th Cir. 1986) 9, 17, 18, 20
Woermann Constr. Co. v. Southwestern Bell Tel. Co., 846 S.W.2d 790 (Mo. Ct. App. 1993) 23

STATUTES

9 U.S.C. § 2 ..... *passim*
9 U.S.C. § 202 16
28 U.S.C. § 1257(a) 1
Conn. Gen. Stat. § 52-408 (1995) 22
Ga. Code Ann. § 9-9-2(c) (Michie Supp. 1994) 21, 22
Iowa Code § 679A.1(2)(c) (1995) 21
Mo. Rev. Stat. § 435.460 (1994) 17, 21
Mont. Code Ann. § 27-5-114(2)(b) (1993) 22
Mont. Code Ann. § 27-5-114(4) (1993) 2, 3, 6, 10, 13
R.I. Gen. Laws § 10-3-2 (Supp. 1994) 21
S.C. Code Ann. § 15-48-10(a) (Law. Co-op. Supp. 1993) 21
Tenn. Code Ann. § 29-5-302(a) (Supp. 1994) 21
Tex. Rev. Civ. Stat. Ann. art. 224(b), (c) (West Supp. 1994) 21
Vt. Stat. Ann. tit. 12, § 5652(b) (Supp. 1994) 15, 21

MISCELLANEOUS

Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 Hofstra L. Rev. 385 (1992) 20, 22
Uniform Arbitration Act (1955), 7 U.L.A. 1 (West 1985 & Supp. 1994) 13

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,
Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,
Respondents.

Petition for a Writ of Certiorari to the Supreme Court of Montana

---

PETITION FOR A WRIT OF CERTIORARI

Doctor's Associates, Inc. and Nick Lombardi respectfully request that a writ of certiorari issue to review the judgment of the Supreme Court of Montana in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Montana is reported at 886 P.2d 931. It is reprinted in the appendix to this petition at 1a-36a. The order of the Montana Eighth Judicial District Court is not reported. It is reprinted in the appendix to this petition at 39a-40a.

JURISDICTION

The Supreme Court of Montana entered judgment on December 15, 1994. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(a).

STATUTORY PROVISIONS INVOLVED

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, provides:

> **Validity, irrevocability, and enforcement of agreements to arbitrate**
>
> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 27-5-114(4), Montana Code Annotated, provides:

> Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.

The full text of Section 27-5-114, which governs the validity of arbitration agreements under Montana law, is set out in the appendix to this petition. Pet. App. 41a.

STATEMENT

A. Introduction

This case arises from the refusal of the Montana Supreme Court to enforce an agreement by the parties to arbitrate their disputes. Although the agreement met all of the requirements of Section 2 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 2—which makes arbitration agreements "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract"—the Montana Supreme

Court held that the agreement was unenforceable because it did not comply with a provision of Montana's arbitration act requiring notice that a contract is subject to arbitration to be typed in underlined capital letters on the first page of the contract. *See* Mont. Code Ann. § 27-5-114(4) (1993). In so doing, the court rejected Petitioners' argument that the Montana statute, which applies only to agreements to arbitrate and not other agreements, is preempted by Section 2 of the FAA.

B. Factual Background

Petitioner Doctor's Associates, Inc. ("DAI") is the national and international franchisor of Subway sandwich shops.[1] DAI has sold a total of over 8,500 Subway franchises throughout the United States. Pet. App. 39a; *see also id.* 27a (Weber, J., dissenting). Petitioner Nick Lombardi is DAI's development agent in Montana.

On April 25, 1988, respondent Paul Casarotto entered into a franchise agreement with DAI to open a Subway shop in Montana. Pet. App. 3a. The franchise agreement was a standard agreement used by DAI with its franchisees. The agreement contained an express arbitration clause providing that "[a]ny controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration."[2]

---

[1] During the events in question, DAI was a Connecticut corporation with its principal place of business in Connecticut. As a result of a merger in 1991, it is now a Florida corporation.

[2] The full text of the arbitration clause (Pet. App. 3a-4a) is as follows:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out

Another section of the franchise agreement provided that "[t]his Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut." Pet. App. 5a. Just above the signature block, the agreement provided as follows: "Each of the parties hereto acknowledges that he has read and understands this Agreement and consents to be bound by all of its terms and conditions." Appendix to Brief for the Appellants, Exhibit 1 (attachment A), *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994).[3] The agreement was executed by DAI and Paul Casarotto.

C. Proceedings Below

A dispute subsequently arose between the parties. Despite the agreement to arbitrate all disputes, however, Casarotto brought suit against DAI, Lombardi and others in the Montana Eighth Judicial District Court, Cascade County.[4] In the suit, he alleged that he had entered into

---

of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

[3] Respondent Paul Casarotto filed an affidavit in the Montana state district court, averring that "I read the agreement over before I signed it," although he goes on to state that "no one ever told or explained to me that the agreement contained an arbitration clause or that the agreement was to be interpreted according to the laws of the State of Connecticut." Appendix to Brief for the Appellants, Exhibit 2, ¶ 8, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994). DAI also provided Casarotto a detailed franchise offering circular that contained the following notice on the first page as required by the Federal Trade Commission: "READ ALL OF YOUR CONTRACT CAREFULLY. BUYING FRANCHISE [sic] IS A COMPLICATED INVESTMENT. TAKE YOUR TIME TO DECIDE. IF POSSIBLE, SHOW YOUR CONTRACT AND THIS INFORMATION TO AN ADVISOR, SUCH AS A LAWYER OR AN ACCOUNTANT." *Id.*, Exhibit 3, at 1. The offering circular also stated that the franchise agreement contained a binding arbitration agreement. *Id.*, Exhibit 3, at 18a.

[4] The suit named Paul Casarotto and his wife, Pamela Casarotto, as plaintiffs. Paul and Pamela Casarotto asserted claims against

the franchise agreement and had opened a store on the west side of Great Falls in reliance on false representations of DAI and Lombardi that he would have an exclusive right to open a store in a different part of town when that location became available. He also alleged that DAI and Lombardi had interfered with efforts to sell his store. He asserted state-law claims against DAI and Lombardi for tortious interference with business relations, breach of covenant of good faith and fair dealing, fraud, constructive fraud, negligent misrepresentation, deceit, and violations of the Montana Consumer Protection Act. Pet. App. 3a.

Citing the arbitration provisions in the franchise agreement, DAI and Lombardi moved in the state district court to dismiss or stay the judicial proceedings against them pending arbitration. DAI and Lombardi argued that Section 2 of the FAA required arbitration of the claims, that the FAA preempted any state law impeding enforcement of a contractual agreement to arbitrate, and that, in any event, Montana law was inapplicable to the parties' agreement because the agreement contained the parties' choice of Connecticut law. DAI also filed a Demand for Arbitration with the American Arbitration Association. Pet. App. 4a, 40a.

The Montana district court granted Petitioners' motion to stay the lawsuit as against them pending arbitration. The court found that the parties' franchise agreement involved interstate commerce within the meaning of Section 2, that the claims asserted against DAI and Lom-

---

defendants other than DAI and Lombardi with whom they did not have an arbitration agreement. Those claims were not the subject of the opinion and orders below. With respect to the claims asserted against DAI and against Lombardi as DAI's agent, only Paul Casarotto had entered into the franchise agreement with DAI, and it is clear from the complaint that only he, and not his wife, is asserting claims against DAI and Lombardi. However, the opinions below referred to the plaintiffs in the plural and treated both plaintiffs alike.

bardi were encompassed by the agreement's arbitration clause, and that DAI had properly demanded arbitration of those claims. The court ordered that the claims against DAI and Lombardi "are hereby stayed until the arbitration has been had in accordance with the terms of the arbitration agreement." Pet. App. 39a-40a.

The Montana Supreme Court, sitting en banc (Pet. App. 37a), reversed the district court in a 4-3 decision. Although the court did not dispute that the arbitration agreement met the requirements of federal law,[5] it nonetheless refused to enforce the agreement on the ground that it did not comply with particular state notice requirements applicable only to arbitration agreements. *See* Mont. Code Ann. § 27-5-114(4) (1993). Pet. App. 17a. That statute provides that a contract must contain a notice that it is subject to arbitration in underlined capital letters on the first page of the contract, otherwise "the contract may not be subject to arbitration." The statute, by its terms and as interpreted by the Montana Supreme Court (Pet. App. 9a-10a, 41a), affects the enforceability of arbitration agreements but not other types of contracts.

The decision of the Montana Supreme Court not to enforce the parties' agreement to arbitrate proceeded in several steps. First, before reaching the question of whether the FAA preempts state arbitration laws, the court determined that it would apply Montana, not Connecticut, law to the agreement in this case. Although the parties had explicitly provided in their contract that Connecticut law would govern the agreement, the Montana Supreme Court rejected that selection. Instead, it ruled that Montana's arbitration notice statute (which had no counterpart in Connecticut law) constituted a fundamental

---

[5] The Montana Supreme Court's opinion did not disturb the trial court's rulings that the parties' agreement to arbitrate involved interstate commerce, that the claims against DAI and Lombardi were encompassed by the agreement, and that DAI had filed a demand for arbitration.

public policy that could not be thwarted by the parties' choice of a different state's law. According to the court, the public policy of requiring notice of a contractual arbitration clause reflected state legislative concerns that Montanans receive sufficient notice before agreeing to a dispute resolution procedure—namely, arbitration—that was potentially inconvenient, expensive and devoid of the procedural safeguards of a judicial proceeding. Pet. App. 9a-10a.

Having decided to apply Montana law to the parties' agreement to arbitrate, the Montana Supreme Court next considered whether Montana's arbitration notice statute was preempted by the FAA. The court acknowledged decisions of this Court holding that Section 2 of the FAA created federal substantive law binding on the states on the issue of the enforceability of arbitration agreements. Pet. App. 10a-12a. The Montana Supreme Court nevertheless interpreted this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), as retreating from earlier decisions by allowing courts to apply state arbitration laws so long as such laws do not "undermine the goals and policies of the FAA." Pet. App. 13a-15a. The Montana court then concluded that a notice statute ensuring that parties had "knowingly" entered into an arbitration agreement was consistent with the policies underlying the FAA as construed in *Volt*. Pet. App. 16a-17a.[6]

In deciding that Montana's arbitration notice statute was not preempted by Section 2 of the FAA, the Montana Supreme Court declined to follow contrary decisions from

---

[6] The court stated that it was of no significance that *Volt* had upheld a court's application of California law to an arbitration agreement where the parties had expressly chosen to abide by California law, whereas in this case the court was applying Montana law despite the parties' choice to be bound by Connecticut law. Pet. App. 15a.

three federal courts of appeals and from the Missouri Supreme Court, all of which held that state arbitration notice requirements are preempted by the FAA. The court found those decisions unpersuasive because they either preceded *Volt* or contained little or no reference to *Volt*. The court found more persuasive decisions by intermediate state courts in Indiana and Texas that cited *Volt* in ruling that notice provisions in state arbitration acts are not preempted by the FAA. Pet. App. 16a.[7]

REASONS FOR GRANTING THE WRIT

This case presents an important issue regarding the scope of Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2. Although that section provides that written arbitration agreements are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract," the Montana Supreme Court refused to enforce the agreement here because it did not comply with a state statute requiring that notice of an agreement to arbitrate (but no other contractual term) be typed in underlined capital letters on the first page of a contract.

This decision merits review for several reasons. To begin with, it rests upon a serious misreading of the language of Section 2 and of the decisions of this Court construing that language. Section 2 plainly states that written arbitration agreements involving interstate commerce are to be enforced "save upon such grounds as exist . . . for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). This Court has repeatedly read that language—most recently in *Allied-Bruce Terminix Companies v.*

[7] The author of the court's opinion also wrote separately to express his "personal observation" that federal appellate judges had misinterpreted the FAA and thus had unnecessarily and inappropriately deprived individuals of access to a system of justice available only in the courts. Pet. App. 18a-22a. Three of the seven Justices on the Montana Supreme Court dissented from the court's opinion. Pet. App. 23a-36a.

Dobson, 115 S. Ct. 834 (1995)—to mean that state laws that condition enforcement of arbitration agreements on compliance with particular state requirements are preempted unless they apply to enforcement of contract provisions generally, and not just to arbitration provisions. *See id.* at 838-39, 843; *Perry v. Thomas*, 482 U.S. 483, 489-91 & 492 n.9 (1987); *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 24 (1983). Contrary to the reasoning of the Montana Supreme Court, nothing in this Court's decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), lessens the preemptive scope of Section 2. *See, e.g., Mastrobuono v. Shearson Lehman Hutton, Inc.*, 63 U.S.L.W. 4195, 4197 (U.S. Mar. 6, 1995); *Terminix*, 115 S. Ct. at 843.

The decision below is also in direct conflict with the decisions of a number of federal courts of appeals, as well as that of another state supreme court. Those courts relied on the language of Section 2 and the decisions of this Court construing that language to hold that Section 2 preempts state laws conditioning enforcement of arbitration agreements on compliance with notice requirements that do not apply to contracts generally. *David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995, 997-99 (8th Cir. 1972); *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837, 839 (Mo. 1985) (en banc).

Finally, the issues presented here have importance beyond this case. Eight states in addition to Montana have enacted arbitration laws with notice requirements comparable to Montana's or other laws intended to direct particular attention to an arbitration provision in a contract.

See Part III, *infra*. More generally, numerous states have placed conditions on agreements to arbitrate that do not apply to other contracts. *Id.* Taken collectively, these state laws stand as a direct impediment to the national uniformity contemplated by Section 2, leaving persons transacting business in multiple states subject to the vagaries of inconsistent state arbitration laws. Review by this Court is thus necessary to implement Congress's "inten[t] to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." *Southland*, 465 U.S. at 16.

I. THE FEDERAL ARBITRATION ACT PREEMPTS MONTANA'S STATUTORY RESTRICTIONS ON ENFORCEMENT OF ARBITRATION AGREEMENTS.

The question presented by this petition is straightforward. May Montana refuse to enforce an otherwise valid agreement to arbitrate on the ground that the agreement does not comply with notice requirements applicable to arbitration agreements but not to other types of agreements? The language of Section 2, and this Court's consistent construction of that language, make clear that Montana may not. Section 2 expressly preempts the application of Montana's arbitration notice statute, Mont. Code Ann. § 27-5-114(4) (1993), to agreements involving interstate commerce.

The language of Section 2 is plain and unequivocal. With respect to contracts within its ambit—as the contract here, involving an interstate transaction, concededly is—it declares written agreements to arbitrate to be "valid, irrevocable, and enforceable" as a matter of federal law. 9 U.S.C. § 2. To that principle, Section 2 then provides an explicit, and explicitly limited, exception: agreements to arbitrate may be deemed unenforceable "upon such grounds as exist at law or in equity for the revocation of *any* contract." *Id.* (emphasis added). As a matter of plain language, therefore, Section 2 permits courts to apply state laws applicable to contracts generally, but not state

laws singling out arbitration agreements for disfavored treatment.

This reading of Section 2 is confirmed by numerous decisions of this Court. As the Court has recognized, Section 2 embodies a "liberal federal policy favoring arbitration agreements." *Moses H. Cone*, 460 U.S. at 24. Its "basic purpose . . . is to overcome courts' refusals to enforce agreements to arbitrate." *Terminix*, 115 S. Ct. at 838; *accord Mastrobuono*, 63 U.S.L.W. at 4196. By enacting the FAA, Congress "intended courts . . . to 'place such agreements upon the same footing as other contracts.'" *Id.* (quoting *Volt*, 489 U.S. at 474) (internal quotation marks omitted). It thus "withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland*, 465 U.S. at 10; *accord Mastrobuono*, 63 U.S.L.W. at 4196.

The Court has acknowledged only two limitations on the enforceability of arbitration agreements governed by the FAA: "they must be part of a written maritime contract or a contract 'evidencing a transaction involving commerce' and such clauses may be revoked upon 'grounds as exist at law or in equity for the revocation of any contract.'" *Southland*, 465 U.S. at 10-11. The Court has emphasized that it "see[s] nothing in the Act indicating that the broad principle of enforceability [in Section 2] is subject to *any* additional limitations under state law." *Id.* at 11 (emphasis added). As a result, it has said that state law may be applied only if the law "arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry*, 482 U.S. at 493 n.9; *accord Terminix*, 115 S. Ct. at 843. By contrast, "[a] state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. A court may not, then, in assessing the rights of litigants to enforce an arbitration agreement, . . . rely on the uniqueness of an agreement to arbitrate as a basis for a state-law hold-

ing" denying enforcement of the agreement. *Perry*, 482 U.S. at 493 n.9 (citations omitted); *accord Southland*, 465 U.S. at 16-17 n.11.

The Court reemphasized these principles this Term. Reviewing an Alabama law singling out arbitration agreements from other types of agreements for unfavorable treatment, the Court stated that "States may regulate contracts, including arbitration clauses, under general contract law principles . . . . What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. *The Act makes any such state policy unlawful . . . .*" *Terminix*, 115 S. Ct. at 843 (emphasis added); *see also Mastrobuono*, 63 U.S.L.W. at 4197.

Yet Montana has done exactly that which the FAA prohibits. Montana's arbitration law makes unenforceable any agreement to arbitrate that is not accompanied by the prescribed notice. The statute does not affect the validity of contracts generally under Montana law; it limits only the enforcement of arbitration agreements as part of a state policy disfavoring arbitration. As construed by the Montana Supreme Court, the notice statute reflects legislative concern about Montana citizens "entering into an agreement . . . to a procedure as potentially inconvenient, expensive, and devoid of procedural safeguards as the one provided for by the rules of the American Arbitration Association." Pet. App. 10a.[8]

It is precisely this type of focused hostility toward arbitration that Congress sought to overcome when it enacted

---

[8] This same anti-arbitration policy caused the Montana Supreme Court to make a second, related error: its decision to apply Montana law despite the parties' explicit contractual choice of Connecticut law. Although a state may be permitted to apply its conflict of law principles to advance a neutral state policy (for example, a general policy against enforcement of adhesion contracts), it may not apply those principles in order to enforce a state law *discriminating* against arbitration agreements. *See Mastrobuono*, 63 U.S.L.W. at 4197.

the FAA. *Terminix*, 115 S. Ct. at 838.[9] The Montana legislature's attempt to address what it perceived as the inequities of arbitration conflicts directly with Congress's remedial intent in enacting the FAA to eradicate "the old common-law hostility toward arbitration, and the failure of state arbitration statutes to mandate enforcement of arbitration agreements." *Southland*, 465 U.S. at 14. Congress, however, did not disable the states from protecting against unconscionable agreements or unequal bargaining power. The "savings" clause in Section 2 of the FAA permits a state to fashion and enforce principles of contract law that apply to all contracts generally, including agreements to arbitrate. But a state may not enact a law that singles out arbitration agreements for special treatment out of a concern that those agreements in particular may be the product of unequal bargaining power. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991); *Perry*, 482 U.S. at 493 n.9; *Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 726 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990).[10]

The Montana Supreme Court appeared to concede that *Southland* and *Perry*, standing alone, would require enforcement of the arbitration agreement in this case. Pet. App. 10a-13a. The court found its way around *Southland*

---

[9] The notice statute, Mont. Code Ann. § 27-5-114(4) (1993), is part of the Montana Uniform Arbitration Act. However, it is a deviation from the Uniform Arbitration Act (1955), 7 U.L.A. 1 (West 1985 & Supp. 1994), which contains no notice requirement. Montana has enacted other provisions refusing to enforce arbitration in certain types of contracts (Pet. App. 41a), which also are deviations from the uniform act. Montana enacted its arbitration act in 1985 in the wake of the Court's decision in *Southland* that states cannot altogether ban arbitration agreements that are otherwise enforceable under Section 2 of the FAA.

[10] Montana is also free to enforce its special requirements for arbitration agreements where an agreement does not involve interstate commerce or otherwise falls outside the scope of the FAA. As discussed earlier in text, the applicability of the FAA to the agreement in this case is not at issue.

and *Perry*, however, by interpreting *Volt* as limiting Section 2's preemption of state law only to those instances in which the law would "undermine the goals and policies of the FAA." Pet. App. 15a. But *Volt* did no such thing. The Court in *Volt* had no occasion even to consider the preemptive force of Section 2, since the California law chosen by the parties in *Volt* did not render their arbitration agreement unenforceable. As this Court recently explained, *Volt* held only that the FAA requires courts "to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Volt*, 489 U.S. at 478; *see Mastrobuono*, 63 U.S.L.W. at 4197. In other words, the "FAA's pro-arbitration policy does not operate without regard to the wishes of the contracting parties." *Mastrobuono*, 63 U.S.L.W. at 4197; *see Volt*, 489 U.S. at 478.[11]

Nothing in *Volt* detracts from the holdings in *Southland* and *Perry* that Section 2, by its plain language, expressly preempts state laws conditioning enforcement of arbitration agreements on compliance with requirements not applicable to *any* contract. *See Mastrobuono*, 63 U.S.L.W. at 4197. As the Court reaffirmed in *Terminix*, Section 2 must still be read as preempting state laws that place arbitration agreements on an unequal footing with other contracts, as such laws are "*directly* contrary to the Act's language and Congress's intent." *Terminix*, 115 S. Ct. at 843 (emphasis added).[12]

---

[11] The situation here, of course, is the opposite of that presented in *Volt*; here, the parties expressly agreed to apply *Connecticut* law, which contains no special limitations on enforcement of arbitration agreements. Moreover, the Court noted in *Volt* that the state law at issue *fostered* the federal policy favoring arbitration, by resolving a practical problem arising in multiparty disputes that the FAA failed to address. *Volt*, 489 U.S. at 476 n.5. While the FAA might be silent about the procedural situation presented in *Volt*, it speaks in the clearest possible terms to the circumstances under which an agreement to arbitrate must be enforced. *Southland*, 465 U.S. at 10-11.

[12] It is true, as the Montana Supreme Court observed, that the FAA does not "occupy the entire field of arbitration." *Volt*, 489

II. THE DECISION OF THE MONTANA SUPREME COURT IS IN DIRECT CONFLICT WITH DECISIONS OF THE FIRST, SECOND AND EIGHTH CIRCUITS AND THE HIGHEST COURT OF MISSOURI.

The decision below also directly conflicts with decisions by three federal courts of appeals and the Supreme Court of Missouri. Each of those courts has held that Section 2 preempts state laws imposing notice requirements on agreements to arbitrate.

In *David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991), the Second Circuit held that the FAA preempted a Vermont statute, Vt. Stat. Ann. tit. 12, § 5652(b) (Supp. 1994), prohibiting enforcement of an agreement to arbitrate unless it was accompanied by a prominently displayed, signed acknowledgment of arbitration in a form prescribed by the statute.[13] Although the court agreed that the form contract in that case did not comply with the "rigorous standard" for arbitration agreements set forth in the Vermont statute, the court held that the statute was preempted by federal law and ordered the parties to arbitrate their dispute. *Id.* at 249. The court found that the FAA required only that an agreement to arbitrate be in writing, a "standard obvi-

---

U.S. at 477. But under Section 2 of the FAA, the parties may be assured that their agreement to arbitrate will be enforced so long as the agreement is "[a] written provision in . . . a contract evidencing a transaction involving commerce" that is not revocable "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2; *see Southland*, 465 U.S. at 10-11. Any state law that imposes additional obstacles to enforcement of arbitration agreements is preempted under the Supremacy Clause. *Terminix*, 115 S. Ct. at 838-39, 843.

[13] In that case, the parties had signed the defendant's standard-form customer contract that incorporated by reference the rules of a commodities exchange. Those rules, in turn, provided that any dispute arising out of any contract shall be referred to arbitration in accordance with the rules.

ously . . . less rigid than that required by the Vermont statute." *Id.* at 250.[14] Because the Vermont statute "directly clash[ed]" with the FAA, and because it "effectively reincarnate[d] the former judicial hostility towards arbitration," the court held that it was preempted and that the arbitration agreement was enforceable. *Id.*

In *Threlkeld*, 923 F.2d at 250, the Second Circuit expressed its agreement with a similar decision by the First Circuit in *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990). In *Connolly*, the court invalidated Massachusetts regulations that required securities broker-dealers to "fully disclos[e] to the customer in writing the legal effect" of an arbitration clause in a customer account agreement. *Id.* at 1125. The First Circuit ruled that "[t]he FAA prohibits a state from taking more stringent action addressed specifically, and limited, to arbitration contracts. *Id.* at 1120. Finding that the regulations "derive their essential meaning from the fact that a contract to arbitrate is at issue," the court held that the regulations were in conflict with the FAA and were therefore preempted. *Id.* at 1123.[15]

---

[14] The applicable substantive provision of the FAA in *Threlkeld* was Section 202 of the FAA, 9 U.S.C. § 202, rather than Section 2, because the arbitration agreement involved international commerce. *See Threlkeld*, 923 F.2d at 248, 250. Section 202 and Section 2 are similar in that both require a written agreement involving international or interstate commerce to create an enforceable agreement to arbitrate. While Section 2 also requires that the agreement not be revocable upon such grounds as exist for the revocation of any contract, that "savings" clause is not at issue in this case, as the Montana Supreme Court did not (and, obviously, could not), rely on that clause of Section 2 in applying Montana's arbitration-specific notice requirements. *See* Pet. App. 14a-17a.

[15] The author of the Montana Supreme Court's opinion wrote a separate concurring opinion that harshly criticized the First Circuit's decision in *Connolly*, taking the First Circuit to task for failing to consider "the total lack of procedural safeguards in the arbitration process" and the use of arbitration provisions by na-

The First Circuit acknowledged that Massachusetts might have an interest in providing for greater disclosures between broker-dealers and their customers and for better protection of consumers. The court observed that states are free to act to preserve the integrity of the securities business, but not in ways that treat arbitration agreements more harshly than other standard-form consumer contracts. *Id.* at 1124. Although a state may prefer to hold arbitration agreements to stricter standards, the First Circuit, relying on Section 2, concluded that "[t]hat value judgment was within the congressional domain—and only Congress, not the states, may create exceptions to it." *Id.*; *cf. Terminix*, 115 S. Ct. at 843 (O'Connor J., concurring) (concluding that the Court's decision will displace state arbitration laws intended to protect consumers, including South Carolina's law (like Montana's) that requires notice of arbitration to be prominently placed on first page of contract).

The First Circuit in *Connolly* noted the similarity of the Massachusetts regulations to state statutes that the Eighth Circuit had previously held preempted by the FAA. *See Connolly*, 883 F.2d at 1120. In *Webb v. R. Rowland & Co.*, 800 F.2d 803 (8th Cir. 1986), the Eighth Circuit enforced the arbitration provisions in a securities broker's customer contract even though the contract—which specified that Missouri law applied—did not contain a notice of the arbitration provisions in ten-point capital letters above the signature block, as required by Missouri law, Mo. Rev. Stat. § 435.460 (1994). The court cited *Southland*, 465 U.S. at 10-11, for the principle that Section 2 of the FAA provides the only limitations on the enforceability of an arbitration agreement covered by the Act. Thus, the court held that the Missouri notice statute could not be applied to bar enforcement

---

tional companies to "subvert our system of justice." Pet. App. 20a-22a.

of the arbitration agreement in the case before it. *Webb*, 800 F.2d at 806-07.[16]

Finally, the Missouri Supreme Court itself has refused to apply the Missouri statute at issue in *Webb* to invalidate an arbitration agreement involving interstate commerce. *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837 (Mo. 1985) (en banc). The court held that it could not apply the statute to an arbitration agreement within the coverage of the FAA without violating the Supremacy Clause, because the statute "seeks to impose a requirement for contracts to arbitrate which is in addition to the requirements of the Federal Arbitration Act. All that is apparently required under that act is contractual language and format sufficient for an ordinarily written contract." *Id.* at 839 (citation omitted).

These cases, taken together, create a body of law that is in irreconcilable conflict with the decision of the Montana Supreme Court.[17] While the Montana Supreme Court thought that *Volt* had altered the preemptive scope of the federal act, both the Second Circuit and the First Circuit found preemption *after* the decision in *Volt*. The court in *Connolly*, in fact, expressly (and correctly) dis-

---

[16] In *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995 (8th Cir. 1972), the Eighth Circuit also construed Section 2 of the FAA as "plainly void[ing] all [state] doctrines of invalidity, unenforceability and revocability which apply only to arbitration agreements." *Id.* at 998. The court therefore enforced an arbitration agreement that specified Texas law as governing, even though the agreement did not comply with a Texas arbitration law that required the signed acknowledgment of counsel to the contracting parties that the agreement to arbitrate was made upon the advice of counsel.

[17] The Montana arbitration notice statute is indistinguishable from the Vermont, Missouri and Texas statutes and Massachusetts regulations that the First, Second and Eighth Circuits and the Missouri Supreme Court have all found preempted by Section 2. Indeed, a federal court in Montana has held that the Montana notice statute is preempted by the FAA. *Snap-On Tools Corp. v. Vetter*, 838 F. Supp. 468, 472 (D. Mont. 1993).

tinguished *Volt* on the ground that, unlike the Massachusetts regulations, the California regulations applied in *Volt* "did not impinge on the validity or enforceability of the arbitral contract." *Connolly*, 883 F.2d at 1119 n.3. The Montana Supreme Court has thus embraced an interpretation of the FAA based on *Volt* that is squarely rejected by the First Circuit.[18] The clear and direct conflict between the decision of the Montana Supreme Court and the decisions of federal courts of appeals and the Missouri Supreme Court therefore warrants this Court's review.[19]

---

[18] In *Saturn Distribution Corp. v. Williams*, 905 F.2d 719, 723-27 (4th Cir.), *cert. denied*, 498 U.S. 983 (1990), the Fourth Circuit considered and rejected the same argument accepted by the Montana Supreme Court: "the notion . . . that the [state] statute may be harmonized with the FAA because it only ensures 'consensual rather than forced arbitration.'" *Id.* at 726 (quoting *Saturn Distribution Corp. v. Williams*, 717 F. Supp. 1147, 1151 (E.D. Va. 1989)). The Fourth Circuit concluded that *Volt* "is not to the contrary." *Id.* While the Virginia statute preempted in *Saturn* imposed restrictions on arbitration different from the notice requirements at issue in this case, the Fourth Circuit's reliance on *Webb* and *Connolly*, *see Saturn*, 905 F.2d at 723-24, strongly indicates that the Fourth Circuit would differ with the Montana Supreme Court on the preemption question presented here.

[19] The Montana Supreme Court recognized that its decision was in conflict with the decisions cited above, but chose instead to follow the lead of two state intermediate appellate courts that had read *Volt* as authority to invalidate arbitration agreements that did not comply with state arbitration notice statutes. Pet. App. 16a; *see American Physicians Service Group Inc. v. Port Lavaca Clinic Associates*, 843 S.W.2d 675, 678 (Tex. Ct. App. 1992) (en banc) ("Texas Act prevails over the FAA"), *writ of error denied* (Tex. Apr. 21, 1993); *Albright v. Edward D. Jones & Co.*, 571 N.E.2d 1329, 1332-33 (Ind. Ct. App. 1991); *transfer denied* (Ind. Feb. 27, 1992), *cert. denied*, 113 S. Ct. 61 (1992). The decision by the Indiana Court of Appeals, although erroneous in its failure to find preemption, was inappropriate for review by this Court because the state court's judgment was ultimately based on the independent state ground that the arbitration agreement did not encompass the plaintiff's claims. *See Albright*, 571 N.E.2d at 1333-34.

III. THE MONTANA SUPREME COURT'S DECISION RAISES ISSUES OF NATIONAL IMPORTANCE.

The decision below, if left standing, would seriously disrupt the national uniformity that Congress sought to achieve by putting arbitration agreements on the same footing as other contracts. Arbitration agreements like the one in this case have become a common feature in business and consumer relationships. Financial institutions, franchisors, manufacturers, and a multitude of other companies conducting interstate businesses now include arbitration agreements in their contracts. *See generally* Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law?*, 21 Hofstra L. Rev. 385, 429-54 (1992). As the case law indicates, national and international economies have come to rely on arbitration in a variety of circumstances. *See, e.g., Threlkeld*, 923 F.2d at 246-47 (contract between member of foreign commodities exchange and American trader); *Connolly*, 883 F.2d at 1116 (customer agreement with securities broker); *Webb*, 800 F.2d at 804-05 (same); *Collins*, 467 F.2d at 996 (purchase agreement between manufacturer and its supplier of computer parts); *Bunge*, 685 S.W.2d at 838 (commercial contract for bulk purchase of soybeans).

It is thus of particular importance that parties to arbitration agreements be assured that their arbitration agreements are enforceable regardless of whether a particular state is receptive to, or hostile to, arbitration. The decisions of the First, Second and Eighth Circuits and the Missouri Supreme Court, by preempting state arbitration notice requirements, affirmed the validity of standardized arbitration provisions that have flourished as a chosen means of resolving disputes. As this Court has found, Congress sought to confer the advantages of arbitration on consumers and businesses alike, *Terminix*, 115 S. Ct. at 842-43, by providing for "rapid and unobstructed enforcement of arbitration agreements." *Moses H. Cone*, 460 U.S. at 23. But the Montana Supreme Court's deci-

sion, along with those of the Texas and Indiana intermediate appellate courts (see note 19 *supra*), creates new uncertainty in the law that undermines Congress's support of arbitration as an alternative device for dispute resolution.

The rule of law announced by the Montana Supreme Court does not take into account the varying, even conflicting, arbitration laws that exist from state to state and their impact on interstate commerce. State arbitration notice provisions are far from uniform. Montana and three other states impose varying notice requirements for contracts subject to an agreement to arbitrate.[20] An additional five states have enacted differing laws regulating the placement and acknowledgment of arbitration agreements within certain kinds of contracts.[21] Furthermore,

---

[20] Mo. Rev. Stat. § 435.460 (1994) (notice that contract contains arbitration agreement must be placed adjacent to signature block in ten-point capital letters); S.C. Code Ann. § 15-48-10(a) (Law. Co-op. Supp. 1993) (notice that contract is subject to arbitration shall be typed in underlined capital letters or rubber-stamped prominently on first page of contract); Vt. Stat. Ann. tit. 12, § 5652(b) (Supp. 1994) (parties must sign written acknowledgment of arbitration that contains language provided in statute and that is prominently displayed in contract).

[21] Ga. Code Ann. § 9-9-2(c)(8), (9) (Michie Supp. 1994) (arbitration provisions in residential real estate contracts and employment contracts must be separately initialed at the time of contract's execution); Iowa Code § 679A.1(2)(c) (1995) (agreement to arbitrate tort claims must be in separate writing executed by parties); R.I. Gen. Laws § 10-3-2 (Supp. 1994) (arbitration provisions in insurance contracts must be placed immediately above parties' signatures); Tenn. Code Ann. § 29-5-302(a) (Supp. 1994) (arbitration clause in contracts relating to farm or residential property must be separately signed or initialed by parties); Tex. Rev. Civ. Stat. Ann. art. 224(b) (West Supp. 1994) (excluding from arbitration act any contract by an individual person for acquisition of property or services where consideration is $50,000 or less unless parties agree in writing to submit to arbitration and such agreement is signed by parties and their attorneys); Tex. Rev. Civ. Stat. Ann. art. 224(c) (West Supp. 1994) (personal injury claims excluded

numerous states have placed other conditions on agreements to arbitrate that do not apply to contracts generally. Montana, for example, refuses to enforce arbitration agreements in certain types of contracts where the consideration is $5,000 or less. Mont. Code Ann. § 27-5-114(2)(b) (1993), *cited in Terminix*, 115 S. Ct. at 843 (O'Connor, J., concurring). Pet. App. 41a.[22]

The results of Montana's interpretation of the FAA are evident in this case. The Montana Supreme Court, applying its conflict of law principles, rejected the parties' choice of Connecticut law and instead applied the Montana arbitration act.[23] The parties therefore lost the benefit of their agreement to arbitrate because they failed to comply with a state notice statute that they did not anticipate would ever be applied to their agreement. A company doing business nationally cannot know in what state it might be sued and—after the decision below—which state's arbitration notice statute might apply. Although

---

from scope of arbitration act except upon advice of counsel to both parties as evidenced by written agreement signed by counsel to both parties).

[22] A state-law exclusion from arbitration for small transactions would exclude a significant percentage of disputes that are now subject to arbitration. "[A]ccording to the American Arbitration Association . . . , more than one-third of its claims involve amounts below $10,000 . . . ." *Terminix*, 115 S. Ct. at 843. Georgia similarly excludes from enforcement under its arbitration act any agreement to arbitrate relating to insurance contracts, loan agreements and consumer financing agreements involving $25,000 or less, as well as all contracts involving consumer transactions. Ga. Code Ann. § 9-9-2(c) (Michie Supp. 1994). Similar limitations on the enforceability of arbitration agreements can be found in many states' laws. *See* Strickland, *supra*, at 402 n.98 (citing statutes from 13 different states); *see also Mastrobuono*, 63 U.S.L.W. at 4196 (discussing New York law barring awards of punitive damages in arbitration).

[23] Connecticut law is virtually identical to the FAA in the conditions it imposes for enforcing agreements to arbitrate. *See* Conn. Gen. Stat. § 52-408 (1995).

Section 2 of the FAA does subject parties to state laws relating to contracts generally, Congress sought by enacting the FAA to remove special state-imposed obstacles to the parties' attempts to arbitrate their disputes because such differential state law treatment of arbitration provisions would undermine the "declared . . . national policy favoring arbitration." *Southland*, 465 U.S. at 10.

The problems encountered by Petitioners in this case in enforcing their agreement to arbitrate will be exacerbated if other states now adopt Montana's interpretation of the preemptive scope of the FAA.[24] A state such as Alabama that has expressed its hostility toward arbitration by banning enforcement of arbitration agreements, *see Terminix*, 115 S. Ct. at 837, could now express that hostility by enacting new laws imposing specific conditions on enforcing arbitration agreements. In the past, this Court has rejected interpretations of the FAA that "would permit states to override the declared policy requiring enforcement of arbitration agreements." *Southland*, 465 U.S. at 17 n.11. The decision of the Montana Supreme Court resurrects the obstacles that this Court has held were eradicated when Congress enacted legislation making arbitration agreements "valid, irrevocable, and enforceable" as a matter of federal law. 9 U.S.C. § 2.

---

[24] Other state courts have applied their state's arbitration notice statute to the case before them, but those decisions made no mention of the FAA or preemption, presumably because no party contended that the arbitration agreement involved interstate commerce. *E.g., Hefele v. Catanzaro*, 727 S.W.2d 475 (Mo. Ct. App. 1987); *A.C. Beals Co. v. Rhode Island Hosp.*, 292 A.2d 865 (R.I. 1972); *Joder Bldg. Corp. v. Lewis*, 569 A.2d 471 (Vt. 1989). At the same time, some state courts have found their own state's notice statutes preempted by the FAA. *E.g., McCarney v. Nearing, Staats, Prelogar & Jones*, 866 S.W.2d 881, 887-88 (Mo. Ct. App. 1993), *transfer denied* (Mo. Jan. 25, 1994); *Woermann Constr. Co. v. Southwestern Bell Tel. Co.*, 846 S.W.2d 790, 792-93 (Mo. Ct. App. 1993); *Godwin v. Stanley Smith & Sons*, 386 S.E.2d 464, 467 (S.C. Ct. App. 1989).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

MARK R. KRAVITZ *
JEFFREY R. BABBIN
WIGGIN & DANA
One Century Tower
P.O. Box 1832
New Haven, CT 06508-1832
(203) 498-4400

H. BARTOW FARR, III
FARR & TARANTO
2445 M Street, N.W.
Washington, D.C. 20037
(202) 775-0184

Dated: March 14, 1995

* Counsel of Record

APPENDICES

BEST AVAILABLE COPY

APPENDIX A

[Filed Dec. 15, 1994]

IN THE SUPREME COURT
OF THE STATE OF MONTANA
1994

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,
Defendants and Respondents,

and

DANIEL L. and DEB HUDSON, and
D&D SUBWAY CORPORATION,
Defendants.

Appeal from District Court of the Eighth Judicial District,
In and for the County of Cascade,
The Honorable John M. McCarvel, Judge presiding

Submitted: April 19, 1994

Decided: December 15, 1994

Justice Terry N. Trieweiler delivered the opinion of the Court.

Plaintiffs Paul and Pamela Casarotto filed this suit in the District Court for the Eighth Judicial District in Cascade County to recover damages which they claim were caused by the defendants' breach of contract and tortious conduct. Defendants Nick Lombardi and Doctor's Associates, Inc. (DAI), moved the District Court for an order dismissing plaintiffs' complaint, or in the alternative, staying further judicial proceedings pending arbitration of plaintiffs' claims pursuant to a provision in DAI's franchise agreement with plaintiffs which required that disputes "arising out of or relating to" that contract be settled by arbitration. The District Court granted defendants' motion, and ordered that further judicial proceedings be stayed until arbitration proceedings were completed in accordance with the terms of the parties' agreement. Plaintiffs appeal from that order. We reverse the order of the District Court.

The issues raised on appeal are:

1. Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

2. If the contract is governed by Montana law, is the notice requirement in § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988)?

FACTUAL BACKGROUND

On October 29, 1992, Paul and Pamela Casarotto filed an amended complaint naming Doctor's Associates, Inc., and Nick Lombardi as defendants. For purposes of our review of the District Court's order, we presume the facts alleged in the complaint to be true.

DAI is a Connecticut corporation which owns Subway Sandwich Shop franchises, and Lombardi is their development agent in Montana. The Casarottos entered into a franchise agreement with DAI which allowed them to

open a Subway Sandwich Shop in Great Falls, Montana. However, they were told by Lombardi that their first choice for a location in Great Falls was unavailable.

According to their complaint, the Casarottos agreed to open a shop at a less desirable location, based on a verbal agreement with Lombardi that when their preferred location became available, they would have the exclusive right to open a store at that location. Contrary to that agreement, the preferred location was subsequently awarded by Lombardi and DAI to another franchise. As a result, the Casarottos' business suffered irreparably, and they lost their business, along with the collateral which secured their SBA loan.

This action is based on the Casarottos' allegation that Lombardi and DAI breached their agreement with the Casarottos, defrauded them, breached the covenant of good faith and fair dealing, and engaged in other tortious conduct, all of which directly caused the Casarottos loss of business and the resulting damage.

DAI's franchise agreement with the Casarottos was executed on April 25, 1988. There was no indication on the first page of the contract that it was subject to arbitration. However, paragraph 10(c) of the contract, found on page 9, included the following provision:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost

> of such a proceeding will be born equally by the parties.

On January 29, 1993, DAI moved the District Court to dismiss the Casarottos' complaint, or at least stay further judicial proceedings, pending arbitration pursuant to paragraph 10(c) of the franchise agreement. DAI alleged that the franchise agreement affected interstate commerce, and therefore, was subject to the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988). They sought a stay of proceedings pursuant to § 3 of that Act, which provides in relevant part that:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement . . . .

DAI claimed that Montana law could not be raised as a bar to enforcement of the arbitration provision for two reasons: First, the contract specifically called for the application of Connecticut law; and second, Montana law was preempted by the Federal Arbitration Act.

The Casarottos opposed DAI's motion on the grounds that Montana law applied, in spite of the choice of law provision in the contract, and that based on § 27-5-114 (4), MCA, the contract's arbitration provision was unenforceable because DAI had not provided notice on the first page of the agreement that the contract was subject to arbitration.

On June 2, 1993, the District Court issued its order granting DAI's motion to stay further judicial proceed-

ings pursuant to 9 U.S.C. § 3. The order was made applicable to both DAI and Lombardi, but not to other named defendants who were not parties to the franchise agreement and whose alleged conduct raises other issues. On July 8, 1993, the District Court issued an order pursuant to Rule 54(b), M.R.Civ.P., certifying its June 2 order as final for purposes of appeal. The Casarottos appeal from that order.

ISSUE 1

Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

Paragraph 12 of the franchise agreement entered into between the parties provides as follows: "This agreement shall be governed by and construed in accordance with the laws of the State of Connecticut and contains the entire understanding of the parties." DAI contends that, therefore, Connecticut law governs our interpretation of the contract and that since Connecticut law is identical to the Federal Arbitration Act *see* Conn. Gen. Stat. § 52-409 (1993), conspicuous notice that the contract was subject to arbitration was not required and we need not concern ourselves with the issue of whether Montana law is preempted.

The Casarottos respond that the issue of whether to apply Connecticut or Montana law involves a conflict of law issue and that the answer can be found in our prior decisions. We agree.

In *Emerson v. Boyd* (1991), 247 Mont. 241, 805 P.2d 587, we cited with approval the Ninth Circuit's decision in *R.J. Williams Co. v. Fort Belknap Housing Authority* (9th Cir. 1983), 719 F.2d 979, which adopted the criteria established in Restatement (Second) of Conflict of Laws § 188 (1971) to determine which jurisdiction's laws apply to a contract where no choice of law is provided for in the contract. Section 188 provides as follows:

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 197), the context to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

(a) the place of contracting,

(b) the place of negotiation of the contract,

(c) the place of performance,

(d) the location of the subject matter of the contract, and

(e) the domicil, residence, nationality, place of incorporation and place of business of the parties.

These contracts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203.

In this case, there is a choice of law provision in the parties' contract. The question is whether it was an "effective" choice. We recently held in *Youngblood v. American States Ins. Co.* (1993), 262 Mont. 391, 394, 866 P.2d 203, 205, that this State's public policy will ultimately determine whether choice of law provisions in contracts are "effective." In that case, we stated:

Here, the general policy language in the insurance contract requires American States to pay whatever damages are required in Montana; that is, the con-

> tract is to be performed in Montana. Therefore, unless a contract term provides otherwise, *Kemp* [*v. Allstate Ins. Co. (1979), 183 Mont. 526, 601 P.2d 20*] and § 28-3-102, MCA, require the application of Montana law because the contract was to be 'performed' in Montana. In this case, however, the insurance contract contains a choice of law provision which requires the application of Oregon subrogation law. . . .
>
> . . . .
>
> . . . [T]he choice of law provision will be enforced unless enforcement of the contract provision requiring application of Oregon law as regards subrogation of medical payments violates Montana's public policy or is against good morals.

Youngblood, 866 P.2d at 205.

Based on our conclusion in that case that subrogation of medical payment benefits was contrary to our public policy, we held that:

> [T]he choice of law provision in the insurance contract would result in medical payment subrogation under Oregon law. Because such subrogation violates Montana's public policy, that term of the insurance contract at issue here is not enforceable.

Youngblood, 866 P.2d at 208.

Restatement (Second) of Conflict of Laws § 187(2) (1971) is consistent with our decision in *Youngblood,* and expands upon the factors to be considered under the circumstances in this case. It provides that:

> (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

Adopting § 187, then, as our guide, we first look to § 188 to determine whether Montana law would be applicable absent an "effective" choice of law by the parties.

According to the affidavit of Paul Casarotto filed in opposition to DAI's motion to dismiss, he executed the contract in neither Connecticut nor Montana. It was executed while he was traveling in New York. However, it appears from that same affidavit, and from the allegations in the complaint, that original negotiations were conducted by him in Great Falls, the contract was to be performed in Great Falls, the subject matter of the contract (the Subway Sandwich Shop) was located in Great Falls, and that he and Pamela Casarotto resided in Great Falls at the time that the contract was executed. The only connection to Connecticut was that DAI was incorporated in that state and apparently had its home office in that state at the time of the parties' agreement. We conclude that based upon the application of the criteria set forth in § 188, and our prior decision in *Emerson*, Montana has a materially greater interest than Connecticut in the contract issue that is presented, and that absent an "effective" choice of law by the parties, Montana law would apply.

Our remaining inquiry, then, is whether application of Connecticut law would be contrary to a fundamental

policy of this State by eliminating the requirement that notice be provided when a contract is subject to arbitration.

In *Trammel v. Brotherhood of Locomotive Firemen and Enginemen* (1953), 126 Mont. 400, 409, 253 P.2d 329, 334, we held that the public policy of a state is established by its express legislative enactments. Here, the legislative history for § 27-5-114(4), MCA, makes clear that the legislative committee members considering adoption of the Uniform Arbitration Act had two primary concerns. First, they did not want Montanans to waive their constitutional right of access to Montana's courts unknowingly, and second, they were concerned about Montanans being compelled to arbitrate disputes at distant locations beyond the borders of our State.

The facts in this case, and our recent decision in another case, justify those concerns.

Regardless of the amount in controversy between these parties, the arbitration clause in the Subway Sandwich Shop Franchise Agreement requires that the Casarottos travel thousands of miles to Connecticut to have their dispute arbitrated. Furthermore, it requires that they share equally in the expense of arbitration, regardless of the merits of their claim. Presumably, that expense could be substantial, since under the Commercial Arbitration Rules of the American Arbitration Association (1992), those expenses would, at a minimum, include: the arbitrator's fees and travel expenses, the cost of witnesses chosen by the arbitrator, the American Arbitration Association's administrative charges, and a filing fee of up to $4000, depending on the amount in controversy. For a proceeding involving multiple arbitrators, the administrative fee alone, for which the Casarottos would be responsible, is $150 a day. In addition, since the contract called for the application of Connecticut law, the Casarottos would be required to retain the services of a Connecticut attorney.

In spite of the expense set forth above, the procedural safeguards which have been established in Montana to assure the reliability of the outcome in dispute resolutions are absent in an arbitration proceeding. The extent of pretrial discovery is within the sole discretion of the arbitrator and the rules of evidence are not applicable. The arbitrator does not have to follow any law, and there does not have to be a factual basis for the arbitrator's decision. *See May v. First National Pawn Brokers, Ltd.* (Mont. Dec. 15, 1994), Slip Op. 94-189.

Based upon the determination by the Legislature of this State that the citizens of this State are at least entitled to notice before entering into an agreement which will limit their future resolution of disputes to a procedure as potentially inconvenient, expensive, and devoid of procedural safeguards as the one provided for by the rules of the American Arbitration Association, and the terms of this contract, we conclude that the notice requirement of § 27-5-114, MCA, does establish a fundamental public policy in Montana, and that the application of Connecticut law would be contrary to that policy. Therefore, we conclude that the law of Montana governs the franchise agreement entered into between the Casarottos and Doctor's Associates, Inc.

ISSUE 2

If the contract is governed by Montana law, is the notice requirement in § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. §§ 1-15 (1988)?

DAI contends that even if Montana law is applicable, § 27-5-114(4), MCA, is preempted by the Federal Arbitration Act because it would void an otherwise enforceable arbitration agreement. In support of its argument, DAI relies on U.S. Supreme Court decisions in *Perry v. Thomas* (1987), 482 U.S. 483, 107 S. Ct. 2520, 96 L. Ed. 2d 426, *Southland Corp. v. Keating* (1984), 465

U.S. 1, 104 S. Ct. 852, 79 L. Ed. 2d 1, and *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.* (1983), 460 U.S. 1, 103 S. Ct. 927, 74 L. Ed. 2d 765. These cases have been referred to as "[a] trilogy of United States Supreme Court cases" which "developed the federal policy favoring arbitration and the principle that the FAA is substantive law enacted pursuant to Congress's commerce powers that preempts contrary state provisions." David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of its Scope* 61 Cinn. L. Rev. 623, 630 (1992). From this trilogy, *Southland* and *Perry* appear to be closest on point and warrant some discussion.

Southland Corporation was the owner and franchisor of 7-Eleven Convenience Stores. Its standard franchise agreements, like DAI's included an arbitration provision. Southland was sued in California by several of its franchisees, based on claims which included violations of the disclosure requirements of the California Franchise Investment Law, Cal. Corp. Code § 31000, *et seq.* (West 1977). The California Supreme Court held that the Franchise Investment Law required judicial consideration of claims brought under that statute, and therefore, held that arbitration could not be compelled. The U.S. Supreme Court disagreed, and held that:

> In creating a substantive rule applicable in state as well federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements. We hold that § 31512 of the California Franchise Investment Law violates the Supremacy Clause.

Southland, 465 U.S. at 16 (footnotes omitted).

In *Perry*, the Supreme Court was called upon to reconcile 9 U.S.C. § 2 which mandates enforcement of arbitration agreements, with § 229 of the California Labor Code, "which provides that actions for the collection of wages may be maintained 'without regard to the existence of

any private agreement to arbitrate.'" *Perry*, 465 U.S. at 484 (quoting Cal. Lab. Code § 229 (West 1971)). In that case, Kenneth Thomas sued his former employer for commissions he claimed were due for the sale of securities. His employer sought to stay the proceedings pursuant to §§ 2 and 4 of the Federal Arbitration Act, based on the arbitration provision found in Thomas's application for employment. *Perry*, 465 U.S. at 484-85. In an opinion affirmed by the California Court of Appeals and the California Supreme Court, the California Superior Court denied the motion to compel arbitration. On appeal, the U.S. Supreme Court held that § 2 of the FAA reflected a strong national policy favoring arbitration agreements, notwithstanding "state substantive or procedural policies to the contrary." *Perry*, 482 U.S. at 489. Citing its decision in *Southland*, the Court held that:

> "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." Id. at 16 (footnote omitted). Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. "We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law." *Keating, supra*, at 11.

Perry, 482 U.S. at 489-90.

As additional authority, DAI cites to our own previous decisions which have enforced arbitration agreements in Montana based on *Southland* and *Perry*. *See Downey v. Christensen* (1992), 251 Mont. 386, 825 P.2d 557; *Vukasin v. D.A. Davidson & Co.* (1990), 241 Mont. 126, 785 P.2d 713; *William Gibson, Jr., Inc. v. James Graff Communications* (1989), 239 Mont. 335, 780 P.2d 1131; *Larsen v. Opie* (1989), 237 Mont. 108, 771 P.2d

977; *Passage v. Prudential-Bache Securities, Inc.* (1986), 223 Mont. 60, 727 P.2d 1298.

The Casarottos, however, contend that *Southland* and *Perry* must be considered in light of the Supreme Court's more recent decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University* (1989), 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed. 2d 488, and that our prior arbitration decisions did not deal with the enforceability of arbitration agreements which violated Montana's statutory law. We agree.

In *Volt*, the parties entered into a construction contract which contained an agreement to arbitrate all disputes between the parties relating to the contract. The contract also provided that it would be governed by the law in the state where the project was located. *Volt*, 489 U.S. at 470.

As a result of a contract dispute between the parties, Stanford filed an action in California Superior Court naming Volt and two other companies involved in the construction project. Volt petitioned the Superior Court to compel arbitration of the dispute. However, the California Arbitration Act found at Cal. Civ. Proc. Code § 1280, *et seq.* (West 1982), contained a provision allowing the court to stay arbitration pending resolution of related litigation. On that basis, the Superior Court denied Volt's motion to compel arbitration, and instead, stayed arbitration proceedings pending outcome of the litigation. The California Court of Appeals affirmed that decision, and the California Supreme Court denied Volt's petition for discretionary review. The U.S. Supreme Court granted review and affirmed the decision of the California courts. *Volt*, 489 U.S. at 471-73.

On appeal, the Supreme Court considered Volt's argument that California's arbitration laws were preempted by the Federal Arbitration Act. In its analysis of the preemption issue, the Supreme Court stated that:

> The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. But even when Congress has not completely displaced state regulation in an area, state law may nonetheless be preempted to the extent that it actually conflicts with federal law—that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). *The question before us, therefore, is whether application of Cal.Civ.Proc. Code Ann. § 1281.2(c) to stay arbitration under this contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude that it would not.*

Volt, 489 U.S. at 477-78 (citation omitted; emphasis added).

The Supreme Court explained that the purpose of the Federal Arbitration Act was to enforce lawful agreements entered into by the parties, and not to impose arbitration on the parties involuntarily. It noted that in this case the parties' agreement was to be bound by the arbitration rules from California. Therefore, it held that:

> Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward. By permitting the courts to "rigorously enforce" such agreements according to their terms, see [*Dean Witter Reynolds, Inc. v.*]*Byrd*, [470 U.S.] at 221, we give effect to the contractual rights and expectations of the parties, without doing violence to the policies behind the FAA.

Volt, 489 U.S. at 479.

While the Court in *Volt* applied state laws that had been chosen by the parties in their contract, and this case involves state law which is applied pursuant to conflict of law principles, it has been observed that:

> The real significance of the *Volt* decision is not in the Court's holding, but rather in what the Court failed to hold. For example, the Court found no preemption of the California arbitration law by the FAA. Instead, the Court merely stated that Congress did not intend that the FAA occupy the entire field of arbitration law. Thus, enforcing the California law was merely a procedural issue and did not frustrate the policy behind the FAA of enforcing the agreement.

David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of its Scope* 61 Cinn. L. Rev. 623, 635 (1992) (footnotes omitted).

Section 2 of 9 U.S.C. provides that:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*

(Emphasis added.)

Based upon the Supreme Court's decision in *Volt*, we conclude that the nature of our inquiry is whether Montana's notice requirement found at § 27-5-114(4), MCA, would "undermine the goals and policies of the FAA." We conclude that it does not.

DAI relies on decisions in *Threlkeld & Co., Inc. v. Metallgesellschaft Ltd.* (2d Cir. 1991), 923 F.2d 245, *Securities Industry Ass'n v. Connolly* (1st Cir. 1989), 883 F.2d 1114, *Webb v. R. Rowland & Co., Inc.* (8th Cir. 1986), 800 F.2d 803, and *Bunge Corp. v. Perryville Feed & Produce, Inc.* (Mo. 1985), 685 S.W.2d 837, in support of its argument that notice provisions are preempted by federal law.

The Casarottos, on the other hand, rely on decisions in *American Physicians v. Port Lavaca Clinic* (Tex. Ct. App. 1992), 843 S.W.2d 675, and *Albright v. Edward D. Jones & Co.* (Ind. Ct. App. 1991), 571 N.E.2d 1329, for the principle that since *Volt*, other courts have held that notice provisions in state arbitration laws are not preempted by the Federal Arbitration Act.

However, the cases cited by the parties either precede the Supreme Court's decision in *Volt*, or contain little or no reference to the *Volt* decision. We conclude that none are persuasive, and we must rely on our own analysis of whether Montana's notice requirement undermines the goals and policies of the FAA.

Our conclusion that Montana's notice requirement does not undermine the policies of the FAA is based on the Supreme Court's conclusion that it was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. That Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledged that the interpretation of contracts is ordinarily a question of state law. *Volt*, 489 U.S. at 474.

Presumably, therefore, the Supreme Court would not find it a threat to the policies of the Federal Arbitration Act for a state to require that before arbitration agreements are enforceable, they be entered knowingly. To

hold otherwise would be to infer that arbitration is so onerous as a means of dispute resolution that it can only be foisted upon the uninformed. That would be inconsistent with the conclusion that the parties to the contract are free to decide how their disputes should be resolved.

Montana's notice requirement does not preclude parties from knowingly entering into arbitration agreements, nor do our courts decline to enforce arbitration agreements which are entered into knowingly.

Therefore, we conclude that Montana's notice statute found at § 27-5-114(4), MCA, would not undermine the goals and policies of the FAA, and is not preempted by 9 U.S.C. § 2 (1988).

Because the agreement of the parties in this case did not comply with Montana's statutory notice requirement, it is not subject to arbitration, according to the law of Montana. The District Court's order dated June 2, 1993, is, therefore, reversed, and this case is remanded to the District Court for further proceedings consistent with this opinion.

/s/ Terry Trieweiler
Justice

We concur:

/s/ John Conway Harrison

/s/ William E. Hunt, Sr.

/s/ James C. Nelson
Justices

Justice Terry N. Trieweiler specially concurring.

The majority opinion sets forth principles of law agreeable to the majority of this Court in language appropriate for judicial precedent. I offer this special concurring opinion as my personal observation regarding many of the federal decisions which have been cited to us as authority.

To those federal judges who consider forced arbitration as the panacea for their "heavy case loads" and who consider the reluctance of state courts to buy into the arbitration program as a sign of intellectual inadequacy, I would like to explain a few things.

In Montana, we are reasonably civilized and have a sophisticated system of justice which has evolved over time and which we continue to develop for the primary purpose of assuring fairness to those people who are subject to its authority.

Over the previous 100 years of our history as a state, our courts have developed rules of evidence for the purpose of assuring that disputes are resolved on the most reliable bases possible.

Based on the presumption that all men and women are fallible and make mistakes, we have developed standards for appellate review which protect litigants from human error or the potential arbitrariness of any one individual.

We believe in the rule of law so that people can plan their commercial and personal affairs. If our trial courts decline to follow those laws, our citizens are assured that this Court will enforce them.

We have rules for venue, and jurisdictional requirements based on the assumption that it is unfair to force people to travel long distances from their homes at great expense and inconvenience to prosecute or defend against lawsuits.

We believe that our courts should be accessible to all, regardless of their economic status, or their social im-

portance, and therefore, provide courts at public expense and guarantee access to everyone.

We have developed liberal rules of discovery (patterned after the federal courts) based on the assumption that the open and candid exchange of information is the surest way to resolve claims on their merits and avoid unnecessary trials.

We have contract laws and tort laws. We have laws to protect our citizens from bad faith, fraud, unfair business practices, and oppression by the many large national corporations who control many aspects of their lives but with whom they have no bargaining power.

While our system of justice and our rules are imperfect, they have as their ultimate purpose one overriding principle. They are intended, and continue to evolve, for the purpose of providing fairness to people, regardless of their wealth or political influence.

What I would like the people in the federal judiciary, especially at the appellate level, to understand is that due to their misinterpretation of congressional intent when it enacted the Federal Arbitration Act, and due to their naive assumption that arbitration provisions and choice of law provisions are knowingly bargained for, all of these procedural safeguards and substantive laws are easily avoided by any party with enough leverage to stick a choice of law and an arbitration provision in its preprinted contract and require the party with inferior bargaining power to sign it.

The procedures we have established, and the laws we have enacted, are either inapplicable or unenforceable in the process we refer to as arbitration.

I am particularly offended by the attitude of federal judges, typified by the remarks of Judge Selya in the First Circuit, which were articulated in *Securities Industry Ass'n v. Connolly* (1st Cir. 1989), 883 F.2d 1114,

cert. denied (1990), 495 U.S. 956, 110 S. Ct. 2559, 109 L. Ed. 2d 742.

Judge Selya considered "[i]ncreased resort to the courts" as the cause for "tumefaction of already-swollen court calendars." He refers to arbitration as "a contractual device that relieves some of the organic pressure by operating as a shunt, allowing parties to resolve disputes outside of the legal system." *Connolly*, 883 F.2d at 1116. He states that "[t]he hope has long been that the Act could serve as a therapy for the ailment of the crowded docket." *Connolly*, 883 F.2d at 1116. He then bemoans that fact that, "[a]s might be expected, there is a rub: the patient, and others in interest, often resist the treatment." *Connolly*, 883 F.2d at 1116.

Judge Selya refers to the preference in the various state jurisdictions to resolve disputes according to traditional notions of fairness, and then suggests that "[t]he FAA was enacted to overcome this 'anachronism'." *Connolly*, 883 F.2d at 1119 (citation omitted). He considers it the role of federal courts to be "on guard for artifices in which the ancient suspicion of arbitration might reappear." *Connolly*, 883 F.2d at 1119.

This type of arrogance not only reflects an intellectual detachment from reality, but a self-serving disregard for the purposes for which courts exist.

With all due respect, Judge Selya's opinion illustrates an all too frequent preoccupation on the part of federal judges with their own case load and a total lack of consideration for the rights of individuals. Nowhere in Judge Selya's lengthy opinion is there any consideration for the total lack of procedural safeguards inherent in the arbitration process. Nowhere in his opinion does he consider the financial hardship that contracts, like the one in this case, impose on people who simply cannot afford to enforce their rights by the process that has been forced upon them. Nowhere does Judge Selya acknowledge that the

"patient" (presumably courts like this one) who resists the "treatment" (presumably the imposition of arbitration in lieu of justice) has a case load typically three times as great as Justice Selya's case load.

The notion by federal judges, like Judge Selya, that people like the Casarottos have knowingly and voluntarily bargained and agreed to resolve their contractual disputes or tort claims by arbitration, is naive at best, and self-serving and cynical at worst. To me, the idea of a contract or agreement suggests mutuality. There is no mutuality in a franchise agreement, a securities brokerage agreement, or in any other of the agreements which typically impose arbitration as the means for resolving disputes. National franchisors, like the defendant in this case, and brokerage firms, who have been the defendants in many other arbitration cases, present form contracts to franchisees and consumers in which choice of law provisions and arbitration provisions are not negotiable, and the consequences of which are not explained. The provision is either accepted, or the business or investment opportunity is denied. Yet these provisions, which are not only approved of, but encouraged by people like Judge Selya, do, in effect, subvert our system of justice as we have come to know it. If any foreign government tried to do the same, we would surely consider it a serious act of aggression.

Furthermore, if the Federal Arbitration Act is to be interpreted as broadly as some of the decisions from our federal courts would suggest, then it presents a serious issue regarding separation of powers. What these interpretations do, in effect, is permit a few major corporations to draft contracts regarding their relationships with others that immunizes them from accountability under the laws of the states where they do business, and by the courts in those states. With a legislative act, the Congress, according to some federal decisions, has written state and federal courts out of business as far as these corporations

are concerned. They are not subject to California's labor laws or franchise laws, they are not subject to our contract laws or tort laws. They are, in effect, above the law.

These insidious erosions of state authority and the judicial process threaten to undermine the rule of law as we know it.

Nothing in our jurisprudence appears more intellectually detached from reality and arrogant than the lament of federal judges who see this system of imposed arbitration as "therapy for their crowded dockets." These decisions have perverted the purpose of the FAA from one to accomplish judicial neutrality, to one of open hostility to any legislative effort to assure that unsophisticated parties to contracts of adhesion at least understand the rights they are giving up.

It seems to me that judges who have let their concern for their own crowded docket overcome their concern for the rights they are entrusted with should step aside and let someone else assume their burdens. The last I checked, there were plenty of capable people willing to do so.

/s/ Terry Trieweiler
Justice

Justice Fred J. Weber dissents as follows:

I respect the majority opinion in its expression of the deeply held conviction that arbitration of the type expressed in the contract in this case should not be enforced in Montana and thereby deprive the parties of access to the court system. The answer to such a judicial approach was stated by the United States Supreme Court in Volt Info. Sciences v. Bd. of Trustees (1989), 489 U.S. 468, 478, 109 S.Ct. 1248, 1255, 103 L.Ed.2d 488, 497, in which the United States Supreme Court stated:

> The Act [Federal Arbitration Act] was designed "to overrule the judiciary's longstanding refusal to enforce agreements to arbitrate," . . . and place such agreements "upon the same footing as other contracts," . . . Section 2 of the Act therefore declares that a written agreement to arbitrate in any contract involving interstate commerce or a maritime transaction "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." (Citations omitted.)

I specifically disagree with the majority opinion's refusal to enforce the agreement to arbitrate in the present case.

Issue I

As stated in the majority opinion: Based on conflict of law principles, is the franchise agreement entered into between the Casarottos and DAI governed by Connecticut law or Montana law?

I point out that the issue as stated by the parties essentially was whether an out-of-state corporation can avoid Montana Arbitration Act's conspicuous notice requirement by claiming preemption under the FAA?

The majority opinion refers to this Court's 1991 case of *Emerson v. Boyd.* In determining whether a contract

dispute arose on an Indian reservation, that case adopted language from *R.J. Williams Co.*, a Ninth Circuit case with regard to the factors to be used to determine whether an action did arise on the reservation. In contrast to the present case, *Emerson v. Boyd* did not contain an agreed choice of law as is present in this case. I do not find this to be appropriate authority.

The majority opinion on this issue concludes that the Montana Legislature had determined that its citizens are entitled to notice before entering into an agreement which will limit their future resolution of disputes to a procedure inconvenient, expensive and devoid of procedural safeguards—and further concludes that the notice requirements of § 27-5-114, MCA, established a fundamental public policy in this State which is contrary to the policy of the Connecticut law. On the basis of those conclusions, the majority opinion further concludes that the law of Montana governs. I do not agree with that conclusion.

The key parts of § 27-5-114, MCA, which apply to this issue are the following:

> Validity of arbitration agreement—exceptions. (1) A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.
>
> . . .
>
> (4) Notice that a contract is *subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page* of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration. (Emphasis supplied.)

Our question then becomes whether the contract here is subject to "arbitration pursuant to this chapter" so that the notice must be typed in underlined capital letters on the first page of the contract. Two specific paragraphs

of the contract are controlling here. Section 10(c) of the contract stated in pertinent part:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut, . . .

Section 12 of the agreement further stated:

> 12. This Agreement shall be governed by and construed in accordance with the laws of the State of Connecticut and contains the entire understanding of the parties. Other than the representations contained in the Agreement, the Offering Circular and advertising materials of the Franchisor, no other representations have been made to or relied upon by the Franchisee except as set forth below: (None are set forth)

When the foregoing contract provisions are compared to subsection (4) of § 27-2-114, MCA, it is apparent that these contract provisions do not fit within the statute. There is no statement in the Franchise Agreement which specifies that the contract is subject to arbitration pursuant to Montana law or to the Uniform Arbitration Act as enacted in Montana under §§ 27-5-111 to 115, MCA.

I conclude that the contract provisions are controlling in this instance and that the contract between the parties is not by its terms subject to Montana law or arbitration under Montana law. In fact the reverse is true. As above specified, the agreement requires that the commercial rules of the American Arbitration Association shall be applied in any arbitration, and also provides that the agreement is governed by and construed under the laws of the State of Connecticut. This clearly rebuts any suggestion that this particular contract is subject to arbitration pursuant to the laws of the State of Montana and in

particular § 27-5-114, MCA. I therefore conclude that the notice requirement of § 27-5-114, MCA, does not in any way establish a fundamental public policy which is applicable to the present contract.

I further point out that the reference to Restatement (Second) of Conflict of Laws, § 188 (1971), is applicable only in the absence of an "effective" choice of law and I conclude there was such an effective choice of law in the present case.

Issue II

If the contract is governed by Montana law, is the notice requirement of § 27-5-114(4), MCA, of Montana's Uniform Arbitration Act, preempted by the Federal Arbitration Act found at 9 U.S.C. § 1-15 (1988)?

The majority opinion quotes the following from the 1987 United States Supreme Court opinion of *Perry v. Thomas*:

> . . . Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements. . . . Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce . . . *We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law. . . .* (Emphasis supplied.)

The affidavit of the vice president of DAI establishes without contradiction that the present agreement to arbitrate is part of a contract in interstate commerce:

> 5. Before July 1991, DAI was a corporation organized under the laws of the State of Connecticut, with a principal place of business at 325 Bic Drive, Milford, CT 06460. On July 1, 1991, DAI of Florida merged with DAI of Connecticut, leaving DAI of Florida as a surviving corporation.

6. DAI has sold a total of 8500 Subway franchises in the United States and estimates that there are approximately 7400 stores in operation world wide.

Clearly the present agreement to arbitrate is part of a contract evidencing interstate commerce so the Federal Arbitration Act is applicable.

The majority opinion analyzes the United States Supreme Court's decision in *Volt* and from that concludes that the nature of the inquiry is whether Montana's notice requirement under § 27-5-114(4), MCA, would undermine the goals and policy of the FAA and further concludes it does not. I disagree with that analysis of *Volt*.

In *Volt*, Volt petitioned the California court to compel arbitration of a dispute and the defendant moved to stay arbitration pursuant to California law. The California statute permitted the court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it. The California court stayed the arbitration proceedings pending the outcome of the litigation. In considering whether the California code section in question was preempted by the FAA, the United States Supreme Court stated:

> The FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. . . . But even when congress has not completely displaced state regulation in an area, state law may nonetheless be preempted to the extent that it actually conflicts with federal law—that is, to the extent that it "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." . . . The question before us, therefore, is whether application of Cal. Civ. Proc. Cod. Ann. § 1281.2(c) to stay arbitration under this contract in interstate com-

> merce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA. We conclude it would not.
>
> . . .
>
> . . . Accordingly, we have recognized that the FAA does not require parties to arbitrate when they have not agreed to do so. See id., at 219, 84 L.Ed.2d 158, 105 S.Ct. 1238. (The Act "does not mandate the arbitration of all claims"), nor does it prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement. *It simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms. . .* (Citations omitted.) (Emphasis supplied.)

Volt, 489 U.S. at 477-78, 109 S.Ct. at 1255, 103 L.Ed. 2d at 499-500. The court further stated and concluded:

> Arbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit . . . Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward.

Volt, 489 U.S. at 479, 109 S.Ct. at 1256, 103 L.Ed. at 500. It is essential to keep in mind that the key holding of *Volt* as expressed by the United State Supreme Court was that the agreement to arbitrate should be enforced according to its terms—and that allowed application of the California law which provided for the stay in proceedings where other parties besides the arbitration parties were involved in the case. That conclusion does not assist the majority opinion. The rationale of the *Volt* decision in the present case would require enforcement of the contract as agreed upon by the parties—which would

require application of the American Arbitration Association rules as well as the laws of the State of Connecticut. I conclude that the contract here should be enforced to require application of the American Arbitration Association Rules and the laws of the State of Connecticut under *Volt*.

In addition to the conclusion reached under *Volt*, I will discuss several cases which have concluded that a statutory provision similar to Montana's statutory requirement of a statement in capital letters on page one of a contract is in conflict with the Federal Arbitration Act and therefore not enforceable. In David L. Threlkeld and Co. v. Metallgesellschaft Ltd. (2nd Cir. 1991), 923 F.2d 245, Threlkeld asserted that Vermont law voided any arbitration agreement which does not have a specific acknowledgement of arbitration signed by both parties and where the agreement to arbitrate has not been displayed prominently in the contract. The circuit court acknowledged that Threlkeld was correct in asserting that the contracts did not comply with the rigorous Vermont standard. The circuit court then concluded that the Vermont statute is preempted by federal law and stated:

> Because federal arbitration law governs this dispute, we must determine whether the Vermont statute is sufficiently consistent with federal law that the two may peacefully coexist. . . . The First Circuit has recently held that restrictive provisions similar to those found in the Vermont statute are preempted by federal law. . . .
>
> We agree with the First Circuit that state statutes such as the Vermont statute directly clash with the Convention and with the Arbitration Act because they effectively reincarnate the former judicial hostility towards arbitration. Accordingly *we hold that the Convention and the Arbitration Act preempt the Vermont statute, and that the . . . arbitration pro-*

> *visions, as drafted, are not enforceable.* (Emphasis supplied.)

Threlkeld, 923 F.2d at 250. *Threlkeld* is clear authority for concluding that the Montana statute directly clashes with the Federal Arbitration Act and therefore is not enforceable.

In a similar manner, Bunge Corp. v. Perryville Feed and Produce (Mo.1985), 685 S.W.2d 837, addresses a similar issue. As pointed out by the Missouri court in *Bunge*, the Missouri statute is based on the Uniform Arbitration Act (as is the Montana statute) and contains a provision that each contract shall include a statement in 10 point capital letters which reads substantially as follows: THIS CONTRACT CONTAINS A BINDING ARBITRATION PROVISION WHICH MAY BE ENFORCED BY THE PARTIES. The Missouri Supreme Court then stated:

> It is clear that § 435.460, if applied to this case, seeks to impose a requirement for contracts to arbitrate which is in addition to the requirements of the Federal Arbitration Act. All that is apparently required under that act is contractual language and format sufficient for an ordinary written contract. . . . *If the Missouri statute applies, then a commercial contract sufficient under federal law would be in violation.*
>
> There is a manifest violation of the supremacy clause if our statute is so applied. The Federal Arbitration Act was passed by Congress pursuant to its power to regulate interstate commerce . . . Any requirement of state law which adds a burden not imposed by Congress is in derogation of the Congressional power, and pro tanto invalid. A very recent case so holding is *Southland Corp. v. Keeting*. . .
>
> We do not hold that the Missouri statute is unconstitutional. We simply hold that it may not be

> applied to defeat the arbitration provision of a contract which is within the coverage of the federal statute. . . . (Citations omitted.) (Emphasis supplied.)

Bunge, 685 S.W.2d at 839. The *Bunge* conclusion is directly applicable to our present case. If our Montana statute applies to the present case, then a commercial contract sufficient under federal law would be in violation of the Montana statute even though it meets the requirement of the Federal Arbitration Act. As a result, even if we accept the majority opinion conclusion that the Montana code section applies, I would hold that Montana law may not be applied to defeat the arbitration principles of a contract which is clearly within the coverage of the Federal Arbitration Act.

The District Court held that the Federal Arbitration Act required that the present suit should be stayed until the arbitration has been held in accordance with the terms of the agreement. I would affirm that holding.

/s/ Fred J. Weber
Justice

Chief Justice J. A. Turnage concurs in the foregoing dissent.

/s/ J. A. Turnage
Chief Justice

Justice Karla M. Gray, dissenting.

I respectfully dissent from the Court's opinion on both issues presented therein. I write separately because the reasons for my dissent are not altogether identical to those which form the basis for Justice Weber's dissent.

With regard to issue one, I conclude that the franchise agreement entered into between the Casarottos and DAI was governed by Connecticut law. It is my view that the Court's analysis of this issue is incomplete and erroneous.

I agree with the Court's synopsis of our decision in *Emerson v. Boyd,* and, on the basis that the agreement before us does include a choice of law provision, on the inapplicability of that decision to the case before us. In my view, *Youngblood* also is not on point here, since that case did not relate to whether a statute represents a statement of public policy by the Montana legislature and, if so, the extent of that statement of public policy.

I agree with the Court that Montana has a materially greater interest than Connecticut in the contract issue presented and that, absent an "effective" choice of law by the parties, Montana law would apply. I disagree with the remainder of the Court's discussion and analysis on this issue.

My primary concern is that the Court neither presents nor discusses the specific language contained in the statutory notice requirement. That statute provides that "[n]otice *that a contract is subject to arbitration pursuant to this chapter* shall be typed in underlined capital letters on the first page of the contract; . . . ." Section 27-5-114(4), MCA. By its terms, the franchise agreement before us is subject to Connecticut law, not "this chapter"—the MUAA. The legislature's specific limitation on the applicability of the notice requirement is clear and unambiguous; under such a circumstance, we are obligated to so interpret it (Curtis v. Dist. Court of

21st Jud. Dist. (Mont. 1994), 879 P.2d 1164, 1166, 51 St.Rep. 776, 778) and conclude that the notice requirement is *not* applicable to the contract before us. Since the statute is inapplicable by its terms to the contract, it cannot form the basis of a public policy broad enough to negate the parties' choice of Connecticut law.

The Court does not even address the specific statutory language, preferring to resort inappropriately to generalized legislative history for its overly broad interpretation of the extent to which the notice requirement applies and the extent to which the legislature adopted the notice requirement as a public policy. Had the legislature intended the notice requirement to apply to every arbitration agreement entered into by a citizen or resident of Montana, notwithstanding that some other jurisdiction's law would otherwise apply, it would have done so; it did not. It is inappropriate for the Court to judicially broaden the legislature's clear statute in the guise of a conflict of law analysis.

With regard to issue two, I conclude that even if the Court were correct regarding the applicability of Montana's notice requirement under conflict of law principles, that requirement is preempted by the Federal Arbitration Act (FAA). Therefore, I also dissent from the Court's opinion on this issue.

The Court suggests that the United States Supreme Court's *Volt* decision was a departure from its earlier *Southland/Perry* line of cases. It then presents an inadequate analysis of *Volt*. Finally, the Court concludes, purportedly under a *Volt* analysis, that Montana's notice requirement does not undermine the goals and policies of the FAA. Nothing could be further from the truth.

In *Southland*, the United States Supreme Court was faced with a California statute which required judicial consideration of certain claims brought under it; the California courts held that the statute precluded arbitration

under an agreement containing an arbitration provision. Determining that the FAA was a substantive rule applicable in state courts by which Congress intended "to foreclose state legislative attempts to undercut the enforceability of arbitration agreements," the Supreme Court held that the California statute violated the supremacy clause. *Southland* was decided in 1984.

In 1987, the Supreme Court decided *Perry*, another California case involving a different California statute which—by its terms—provided that legal actions for the collection of wages could be maintained notwithstanding an agreement to arbitrate such claims. Again the California courts denied a motion to compel arbitration under the parties' agreement, favoring their legislature's effort to render arbitration agreements unenforceable. And again the United States Supreme Court reversed, quoting its *Southland* language that Congress intended to foreclose state legislatures from undercutting the enforceability of arbitration agreements. For additional clarity, the Supreme Court added " 'We see nothing in the [FAA] indicating that the broad principle of enforceability is subject to any additional limitations under state law.' " *Perry*, 482 U.S. at 489-90 (citations omitted). *Southland* and *Perry* are, as the Court notes, consistent with each other.

In 1989, the Supreme Court decided *Volt*. There, faced with yet another California statute and another decision from the California courts denying a motion to compel arbitration on the basis of the state statute, the Supreme Court affirmed. Contrary to this Court's suggestion, *Volt* is entirely consistent with—and not a retrenchment from —*Southland* and *Perry*. All three cases require this Court to conclude that Montana's notice requirement is preempted by the FAA.

In *Volt*, the parties had specifically agreed to submit disputes under their contract to arbitration under the California arbitration statutes. The California arbitration

statute at issue in *Volt* differed markedly from those in *Southland* and *Perry*. As noted above, the earlier cases involved statutes which clearly undercut the enforceability of arbitration agreements. In *Volt*, however, the statute—part of the California Arbitration Act—merely allowed a court to *stay* arbitration pending resolution of related litigation; the right to arbitrate remained. The issue before the Supreme Court was the same as in the earlier cases: whether the stay provision would undermine the goals and policies of the FAA.

The Supreme Court reiterated that the purpose of the FAA was to *enforce* arbitration agreements entered into by parties, and specifically noted the parties' agreement to apply California's arbitration rules, one of which permitted the stay of arbitration pending related litigation. On these facts, including the parties' choice of California arbitration law and that that law permitted a stay—but not a voiding—of arbitration, the Supreme Court held that enforcing the California stay provision did not frustrate the policy behind the FAA of enforcing arbitration agreements.

The Court's opinion fails—or refuses—to recognize two important differences between *Volt* and the case presently before us. First, the Supreme Court in *Volt* relied heavily on the fact that the parties had affirmatively chosen California arbitration law, including the stay statute, to govern their agreement. Second, the stay statute did not undercut, undermine or render unenforceable the parties' agreement to arbitrate.

Here, the parties did not affirmatively choose Montana arbitration law, which includes the notice requirement, to govern their agreement. They chose Connecticut law.

Moreover, it is clear under *Southland, Perry* and *Volt* that Montana's notice requirement is preempted by the Federal Arbitration Act. The reason for this constitutes the second important difference between this case and

Volt: here, the application of the notice requirement is not merely a procedural matter; indeed, it totally undermines the purposes of the FAA by rendering the parties' arbitration agreement unenforceable. This is precisely the result prohibited by the United States Supreme Court in all three of the cases discussed herein and in the Court's opinion on this issue.

I would affirm the District Court's grant of defendants' motion to stay judicial proceedings pending arbitration of plaintiffs' claims.

/s/ Karla M. Gray
Justice

Chief Justice J.A. Turnage joins in the foregoing dissent of Justice Karla M. Gray.

/s/ J.A. Turnage
Chief Justice

APPENDIX B

[Filed Feb. 17, 1994]

IN THE SUPREME COURT
OF THE STATE OF MONTANA

No. 93-488

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs and Appellants,

v.

NICK LOMBARDI and DOCTOR'S ASSOCIATES, INC.,
Defendants and Respondents,

and

DANIEL L. and DEB HUDSON, and
D&D SUBWAY CORPORATION,
Defendants.

ORDER

Pursuant to the Internal Operating Rules of this Court, this cause is classified for oral argument before the Court sitting en banc and will be set on a future calendar of this Court.

IT IS ORDERED that counsel for all parties in this appeal are hereby directed to specifically address in oral argument the issue of preemption in the following United States Supreme Court case: *Volt Information Sciences, Inc. vs. Board of Trustees of the Leland Stanford Junior University* (1989), 489 U.S. 468, 103 L.Ed.2d 488, 109 S.Ct. 1248.

This Court will consider receiving amicus curiae briefs relative to this cause.

The Clerk is directed to mail a true copy of this order to counsel of record for all parties and to the Executive Directors of the State Bar of Montana, the Montana Trial Lawyers' Association and the Montana Defense Trial Lawyers' Association.

DATED this 17th day of February, 1994.

For the Court,

By /s/ J.A. Turnage
Chief Justice

APPENDIX C

[Filed Jun. 2, 1993]

MONTANA EIGHTH JUDICIAL DISTRICT COURT
CASCADE COUNTY

No. BDV-92-860

PAUL CASAROTTO and PAMELA CASAROTTO,
Plaintiffs,

vs.

DANIEL L. and DEB HUDSON,
D&D SUBWAY CORPORATION, NICK LOMBARDI,
and DOCTOR'S ASSOCIATES, INC.,
Defendants.

ORDER

This cause is before the Court on the defendants Doctor's Associates, Inc. ("DAI") and Nick Lombardi's motion to dismiss, or in the alternative, to stay pending arbirtation. The Court having considered the briefs, the argument of counsel and the evidence submitted, rules as follows:

1. The plaintiff Paul Casarotto (the "franchisee") and DAI entered into a franchise agreement dated April 25, 1988 that concerned interstate commerce. DAI is the national franchisor of "Subway" sandwich shops and the franchise agreement permits, *inter alia*, the franchisee a license to use the nationally-known and federally-registered "Subway" trademark.

2. The franchise agreement contained a clause requiring that:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Con-

necticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

3. The claims asserted by the plaintiffs against defendants DAI and its alleged agent Lombardi arise out of and relate to the franchise agreement and are therefore encompassed by the arbitration clause and referable to arbitration.

4. The Federal Arbitration Act requires that if an action is brought upon any issue referable to arbitration under the terms of an arbitration agreement, the suit shall be stayed "until such arbitration has been had in accordance with the terms of the agreement. . . ." 9 U.S.C. § 3. *See also, e.g., Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25 (1983); *Downey v. Christensen*, 825 P.2d 557, 559 (Mont. 1992).

5. DAI has demanded arbitration of the plaintiffs' claims under the rules of the American Arbitration Association.

Accordingly, it is ordered and adjudged that plaintiffs' claims against the defendants Doctor's Associates, Inc., and Nick Lombardi are hereby stayed until the arbitration has been had in accordance with the terms of the arbitration agreement.

DONE and ORDERED this 2nd day of June, 1993.

/s/ John M. McCarvel
District Judge

APPENDIX D

STATUTE INVOLVED

Section 27-5-114, Montana Code Annotated

27-5-114. Validity of arbitration agreement—exceptions. (1) A written agreement to submit an existing controversy to arbitration is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.

(2) A written agreement to submit to arbitration any controversy arising between the parties after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract. Except as permitted under subsection (3), this subsection does not apply to:

(a) claims arising out of personal injury, whether based on contract or tort;

(b) any contract by an individual for the acquisition of real or personal property, services, or money or credit where the total consideration to be paid or furnished by the individual is $5,000 or less;

(c) any agreement concerning or relating to insurance policies or annuity contracts except for those contracts between insurance companies; or

(d) claims for workers' compensation.

(3) A written agreement between members of a trade or professional organization to submit to arbitration any controversies arising between members of the trade or professional organization after the agreement is made is valid and enforceable except upon such grounds as exist at law or in equity for the revocation of a contract.

(4) Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.

Supreme Court, U.S.
FILED
MAY 5 1995
OFFICE OF THE CLERK

No. 94-1518

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

DOCTOR'S ASSOCIATES, INC.
and NICK LOMBARDI,

Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Petition for a Writ of Certiorari to
the Supreme Court of Montana

BRIEF FOR THE INTERNATIONAL FRANCHISE ASSOCIATION, AS AMICUS CURIAE SUPPORTING PETITIONERS

JOHN F. VERHEY
Counsel of Record
LEWIS G. RUDNICK
RUDNICK & WOLFE
203 North LaSalle Street
Suite 1800
Chicago, Illinois 60601
(312) 368-4000

MATTHEW R. SHAY
THE INTERNATIONAL
FRANCHISE ASSOCIATION
1350 New York Avenue, N.W.
Suite 900
Washington, D.C. 20005
(202) 628-5000

Counsel for Amicus Curiae

Midwest Law Printing Co., Chicago 60611, (312) 321-0220

22 pp

TABLE OF CONTENTS

	PAGE
TABLE OF AUTHORITIES	ii
INTEREST OF THE AMICUS CURIAE	1
SUMMARY OF ARGUMENT	4
ARGUMENT	7
I.	
THIS COURT SHOULD DECIDE WHETHER A STATE STATUTORY NOTICE PROVISION FOR ARBITRATION IS PREEMPTED BY THE FEDERAL ARBITRATION ACT	7
A. The Montana Supreme Court's Decision Disregards Prior Decisions Of This Court And Other Lower Federal Courts	8
B. The Montana Supreme Court's Decision Distorts This Court's Reasoning In *Volt* .	11
II.	
THE MONTANA SUPREME COURT'S DECISION REPRESENTS UNSOUND PUBLIC POLICY	13
CONCLUSION	18

TABLE OF AUTHORITIES

CASES:	PAGE
Albright v. Edward D. Jones & Co., 571 N.E.2d 1329 (Ind. Ct. App. 1991), *cert. denied*, 113 S. Ct. 61 (1992)	10, 11
Allied-Bruce Terminix Companies, Inc. v. Dobson, 115 S. Ct. 834 (1995)	9, 14
American Physicians Service Group, Inc. v. Port Lavaca Clinic Assoc., 843 S.W.2d 675 (Tex. Ct. App. 1992) (en banc), writ of error denied (Tex. Apr. 21, 1993)	10
Carnival Cruise Lines, Inc. v. Shute, 111 S. Ct. 1522 (1991)	17
Collins Radio Co. v. Ex-Cell-O Corp., 467 F.2d 995 (8th Cir. 1972)	10
David L. Threlkeld & Co., Inc. v. Metallgesellschaft, Ltd. (London), 923 F.2d 245 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991)	10
Gilmer v. Interstate/Johnson Lane Corp., 111 S. Ct. 1647 (1991)	14
Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212 (1995)	9
Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985)	14
Perry v. Thomas, 482 U.S. 483 (1987)	4, 5, 8, 9, 11, 13
Securities Indus. Ass'n v. Connolly, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990)	10
Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987)	14

Southland Corp. v. Keating, 465 U.S. 1 (1984) 4, 5, 8, 9, 11, 13

Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468 (1989) 5, 7, 9, 11, 12, 13

Webb v. R. Rowland & Co., 800 F.2d 803 (8th Cir. 1986) 10

STATUTES:

9 U.S.C. § 2 ..... 5, 8, 9

No. 94-1518

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

DOCTOR'S ASSOCIATES, INC.
and NICK LOMBARDI,

Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Montana

BRIEF FOR THE INTERNATIONAL FRANCHISE ASSOCIATION, AS AMICUS CURIAE SUPPORTING PETITIONERS

INTEREST OF THE AMICUS CURIAE

The International Franchise Association ("IFA"), founded in 1960, is the oldest and largest trade association in the world representing the interests of franchising. IFA has more than 750 franchisor members and, since first inviting franchisees to join in 1993, has already attracted more than 27,000 franchisee members. IFA serves as a resource center for current and prospective franchisors and franchisees, state and federal government agencies, and the

public. IFA also represents the interests of franchising before legislatures, the courts, and the public. The Association has been instrumental in promoting balanced legislation to regulate franchising practices in the United States.

A franchise is a contractual relationship in which the franchisor, the owner of a business concept and associated trademarks or service marks, authorizes a franchisee to conduct a business that is identified by the franchisor's marks and uses the franchisor's format and operating system. The contractual relationship is defined by a franchise or license agreement, which sets forth the respective obligations of the franchisor and franchisee. To promote uniformity in their franchise networks, franchisors utilize standardized agreements. However, such "form" agreements are frequently subject to negotiation. An increasing number of franchising companies, in an effort to resolve disputes with their franchisees in the least costly, least disruptive and most expeditious manner possible, include in their franchise agreements an undertaking to resolve disputes by arbitration, binding on both the franchisor and the franchisee. Such agreements obligate the parties to arbitrate disputes, usually under the auspices of the American Arbitration Association or similar organization, and often in the home state of the franchisor. In the past year alone, almost 400 arbitrations involving franchise relationships were initiated with the American Arbitration Association.

Historically, many state courts and state legislatures have looked dimly on arbitration, especially when it occurred as the result of a pre-dispute agreement to arbitrate. Whether this reluctance to honor agreements to arbitrate stemmed from the belief that arbitration did not afford the same procedural or substantive safeguards as litigation, or whether it grew out of the states' effort to preserve in-state forums for their citizens, the end result

was that arbitration agreements were routinely disregarded. With the passage of the Federal Arbitration Act ("FAA") and rigorous enforcement of arbitration agreements under the FAA, especially by federal courts, most state courts and legislatures grudgingly accepted arbitration as a legitimate means of resolving disputes. In the past several years, however, a backlash has occurred. A number of states, including Montana, have enacted statutes, purportedly under the guise of ensuring that arbitration agreements are freely entered into, that seriously undermine the enforceability of agreements to arbitrate. One of the most prevalent examples of such legislation is the Montana statute that is the subject of the Montana Supreme Court's decision below,[1] which requires that notice of the existence of an agreement to resolve disputes by arbitration be displayed on the first page of the contract in underlined, capital letters, a requirement that is applicable only to arbitration agreements, not to contracts generally. While federal courts have consistently struck down anti-arbitration statutes of this type on preemption grounds, a growing number of state courts, of which the Montana Supreme Court is but the latest example, have held otherwise, permitting states to single out arbitration agreements for unfavorable treatment.

IFA is vitally concerned about this case because permitting the decision of the Montana Supreme Court to stand will encourage other state courts and legislatures to undertake similar steps to undercut the enforceability

---

[1] The Montana Supreme Court's opinion in this case, together with the special concurrence and dissents, is printed as Appendix A to the Petition for a Writ of Certiorari filed with the Court in this case. References to the lower court's opinion are designated "App. A" followed by a page reference.

of agreements to arbitrate and further thwart the strong federal policy favoring arbitration. As a result, franchisors and other businesses that include arbitration provisions in their form agreements will either be forced to tailor their agreements to the laws of 50 different states or forgo the many advantages inherent in the arbitration process. Even now, the inconsistent treatment of arbitration notice provisions by federal and state courts introduces great uncertainty into the franchise relationship and spawns satellite litigation over the enforceability of those provisions that threatens to overwhelm the benefits of economy and efficiency that arbitration was originally intended to produce.

Pursuant to Rule 37.2 of the Rules of this Court, IFA respectively submits this brief as *amicus curiae* in support of petitioners. Because many IFA members, both franchisors and franchisees, utilize arbitration as a means of resolving disputes, IFA has a substantial interest in the outcome of this case and is able to provide an additional and broader prospective on the issues presented. IFA believes this brief will assist the Court in analyzing and resolving these issues. The parties have consented to the filing of this brief, and their written consents have been filed with the Clerk of Court.

SUMMARY OF ARGUMENT

In the decision below, the Montana Supreme Court unduly restricted the preemptive reach of Section 2 of the FAA by holding that Montana's notice requirement for arbitration agreements does not violate the Supremacy Clause. In doing so, the Montana Supreme Court disregarded two controlling decisions of this court, *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and *Perry v. Thomas*, 482 U.S.

483 (1987), which held that states may not restrict the enforceability of agreements to arbitrate except on "grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Since Montana's notice requirement is directed exclusively at arbitration provisions and not at any other contractual terms, it is preempted by the FAA. In addition to conflicting with *Southland* and *Perry*, the Montana Supreme Court's decision also runs directly contrary to the decisions of the three federal courts of appeals that have addressed the issue, all of which held that state arbitration notice requirements are preempted by the FAA. Instead of following these decisions, the court below relied on two intermediate state courts in Indiana and Texas that upheld similar notice provisions. Review of the decision below is necessary to signal to state courts and legislatures that, for purposes of preemption under the FAA, burdening the enforceability of arbitration agreements with a notice provision is no different than declaring those agreements unenforceable *per se*.

In determining that Montana's notice provision did not undermine the goals and policies of the FAA, the Montana Supreme Court also distorted this Court's holding in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989). The decision in *Volt* was premised on the notion that the primary purpose of the FAA is to enforce privately negotiated agreements to arbitrate, even where those agreements allow for arbitration to be stayed pending the resolution of related litigation. Because the parties here chose the AAA's Commercial Arbitration Rules and Connecticut law, not Montana law, to govern their arbitration agreement, *Volt* requires that their choice be upheld and not, as the Montana Supreme Court reasoned, that another state's law be substituted that would invalidate the parties' agreement to arbitrate. In addition, although in *Volt*

this Court observed that the FAA does not entirely preempt state arbitration laws, in particular state laws governing the procedures under which arbitration is conducted, the Montana Supreme Court perverted this holding into a license to enforce a state arbitration law that went to the very substance of the right to arbitrate, prohibiting arbitration from occurring altogether. The Montana Supreme Court's conclusion that the FAA mandates the enforcement only of those arbitration agreements that are entered into "knowingly," which Montana's notice provision is purportedly designed to promote, flies in the face of the FAA's insistence on rigorous enforcement of arbitration agreements. Because of the apparent solicitude for arbitration of the majority of the Montana Supreme Court, when in fact its decision and the statute it enforced are based on hostility to arbitration agreements, it is crucial that this Court grant review of the decision below to discourage similar attempts by state courts and legislatures to undermine the FAA on the pretext of furthering its goals and policies.

The Montana Supreme Court's decision is also premised on judicial and legislative hostility to arbitration, which has long been discredited by this Court in view of the many advantages that arbitration affords over traditional litigation, including speed, economy, adjudicative expertise and the capacity to preserve long-term relationships once the dispute is resolved. To enforce statutes like Montana's either would deprive the parties to a franchise relationship of these advantages altogether, or would seriously impede the use of arbitration in the franchise relationship by burdening franchisors with tailoring their contract documents to meet the requirements of 50 different states relative to the enforceability of arbitration provisions. Moreover, the Montana Supreme Court's reasoning is based

on unsupported and unfounded assumptions regarding the negotiability of arbitration agreements and the role of forum-selection clauses in those agreements.

The decision below introduces rationales that substantially curtail the enforceability of agreements to arbitrate and raise issues of great importance under the FAA and the Supremacy Clause. These issues have enormous significance for a large and growing segment of American business. These are compelling reasons for this Court's review.

ARGUMENT

I.

THIS COURT SHOULD DECIDE WHETHER A STATE STATUTORY NOTICE PROVISION FOR ARBITRATION IS PREEMPTED BY THE FEDERAL ARBITRATION ACT

In holding that the FAA does not preempt Montana's statute requiring that a contract containing an arbitration agreement include a conspicuous notice to that effect on the face of the contract, the Montana Supreme Court disregarded two of this Court's controlling precedents and a substantial number of lower federal court decisions that flatly refute the Montana Supreme Court's holding. In so doing, the Montana Supreme Court has severely restricted the preemptive reach of the FAA. Moreover, the Montana Supreme Court reached its decision by seriously distorting this Court's holding in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), to the point of emasculating the enforceability of agreements to arbitrate under the FAA.

A. The Montana Supreme Court's Decision Disregards Prior Decisions Of This Court And Other Lower Federal Courts

The Montana Supreme Court held that the Montana notice provision is not preempted by Section 2 of the FAA because the notice requirement does not "undermine the goals and policies of the FAA." App. A at 16a. In so holding, however, the Montana Supreme Court disregarded this Court's controlling decisions in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), and *Perry v. Thomas*, 482 U.S. 483 (1987). In holding that a provision of the California Franchise Investment Law requiring judicial consideration of claims brought under the statute was preempted by the FAA, this Court in *Southland* declared that the *only* permissible limitation under state law on the enforceability of agreements to arbitrate (other than the "involving commerce" requirement) was whether those agreements were revocable upon " 'grounds as exist at law or in equity for the revocation of any contract.' " 465 U.S. at 11 (quoting 9 U.S.C. § 2). Likewise, in *Perry*, this Court struck down a provision of the California Labor Code, which precluded arbitration of wage collection claims, on the ground that the California law did not "[arise] to govern issues concerning the validity, revocability, and enforceability of contracts generally," but rather "[took] its meaning precisely from the fact that a contract to arbitrate is at issue." 482 U.S. at 492 n. 9.

The Montana statute at issue here is preempted by the FAA because it clearly "takes its meaning precisely from the fact that a contract to arbitrate is at issue." Montana does not require that any other contractual provision be flagged with a conspicuous notice provision on the first page of the contract. Arbitration agreements alone are burdened with this requirement in Montana—burdened,

in that the absence of such a notice renders the agreement to arbitrate unenforceable. Under this Court's decisions in *Southland* and *Perry*, therefore, the Montana statute is preempted by the FAA.

Indeed, in a recent pronouncement on the FAA, this Court reaffirmed that, under its holdings in *Southland* and *Perry*, the FAA preempts state laws that seek to invalidate arbitration agreements. *See Allied-Bruce Terminix Companies, Inc. v. Dobson*, 115 S. Ct. 834 (1995); *accord Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1215-16 (1995). In *Terminix*, this Court decisively rejected a request to overrule *Southland* and permit state courts to apply their own anti-arbitration laws regardless of whether interstate commerce was involved, holding that *Southland* was well-established law and that, consequently, Alabama could not apply its statute barring pre-dispute arbitration agreements to invalidate an arbitration provision. *Terminix*, 115 S. Ct. at 838-39 After observing that the "basic purpose of the Federal Arbitration Act is to overcome courts' refusal to enforce agreements to arbitrate" and to place those agreements " 'upon the same footing as other contracts,' " *id.* at 838 (quoting *Volt*, 489 U.S. at 474), Justice Breyer, writing for this Court, concluded that while "States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause 'upon such grounds as exist at law or in equity for the revocation of *any* contract'[,] . . . [w]hat States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause," *Terminix*, 115 S. Ct. at 843 (quoting 9 U.S.C. § 2) (emphasis in original). Montana has done in the statute at issue here precisely what this Court and numerous other federal and state courts over the past

decade have held that it cannot do: It has decided that contracts are fair enough to enforce all their basic terms, even absent a special notice designed to bring the existence of those terms to the parties' attention, but that arbitration agreements are not fair enough to enforce without such a notice.

The Montana Supreme Court's holding also disregards the contrary decisions from the three federal courts of appeals that have addressed the issue, all of which have invalidated arbitration notice provisions similar to the Montana statute. *See, e.g., David L. Threlkeld & Co., Inc. v. Metallgesellschaft, Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991) (invalidating a Vermont statute that required agreements to arbitrate to be "prominently displayed" in contracts and signed by the parties); *Securities Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990) (invalidating a state regulation requiring full written disclosure of "the legal effect of the pre-dispute arbitration contract or clause"); *Webb v. R. Rowland & Co.*, 800 F.2d 803, 806-07 (8th Cir. 1986) (invalidating a requirement that contracts highlight the existence of arbitration clauses in 10-point capital letters); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995, 997-99 (8th Cir. 1972) (invalidating a requirement that arbitration agreements bear an attorney's acknowledgement that all parties have been advised of the agreement's effects). Instead, the Montana Supreme Court has joined a growing number of state courts that have reinvigorated the former hostility to arbitration by concluding that arbitration notice provisions do not run afoul of the FAA. *See, e.g., American Physicians Service Group, Inc. v. Port Lavaca Clinic Assoc.*, 843 S.W.2d 675, 678 (Tex. Ct. App. 1992) (en banc), *writ of error denied* (Tex. Apr. 21, 1993); *Albright v. Edward D. Jones & Co.*,

571 N.E.2d 1329, 1332-33 (Ind. Ct. App. 1991), *cert. denied*, 113 S. Ct. 61 (1992). In addition, a number of states have similar laws that single out arbitration agreements for unfavorable treatment by regulating the placement and acknowledgment of arbitration agreements in certain types of contracts. Courts in those states could well be encouraged by the Montana Supreme Court's decision below to uphold similar anti-arbitration statutes against preemption attacks.[2] Thus, there is a compelling need for this Court to review—and reverse—the decision of the Montana Supreme Court in order to signal to state courts and legislatures that, for purposes of preemption under the FAA, statutory notice provisions for arbitration are no less hostile to arbitration than were the statutes at issue in *Southland* and *Perry*.

B. The Montana Supreme Court's Decision Distorts This Court's Reasoning In *Volt*

In sustaining the Montana statute against a preemption attack, the Montana Supreme Court also seriously distorted this Court's reasoning in *Volt* in several respects. First, the decision below completely disregards the parties' arbitration agreement. As this Court observed in *Volt*, the primary purpose of the FAA is to enforce "privately negotiated arbitration agreements," and parties to an arbitration agreement should be "at liberty to choose the terms under which they will arbitrate." 489 U.S. at 472. Here, the parties chose the AAA's Commercial Arbitration Rules and Connecticut law, not Montana law, to govern their arbitration agreement. Since neither

---

[2] *See* Petition for a Writ of Certiorari, at 21 nn. 20 & 21 (citing statutes).

Connecticut law nor the AAA's rules nor the FAA conditions the enforceability of an agreement to arbitrate on the existence of a notice provision, *Volt* cannot support the result reached by the Montana Supreme Court. On the contrary, the very notion of enforcing a notice provision *not* chosen by the parties to invalidate an arbitration provision *chosen* by the parties is completely antithetical to the teaching of *Volt* and strikes at the heart of the FAA's purpose—to ensure that private agreements to arbitrate are rigorously enforced according to their terms.

Second, the Montana Supreme Court's unduly narrow interpretation of the scope of federal preemption of state arbitration laws is impossible to square with *Volt*. Purportedly relying on *Volt*, the Montana Supreme Court declared that Montana's notice requirement does not "undermine the goals and policies of the FAA," because Congress never intended to preempt the entire field of arbitration and because the FAA does not require parties to arbitrate when they have not agreed to do so. App. A at 16a. However, this Court's statement in *Volt* that the FAA does not entirely preempt state arbitration law was made in reference to a California *procedural* statute that merely had the effect of delaying an arbitration until after litigation of related claims had occurred—and under circumstances where the parties had chosen that law to govern their arbitration. Thus, the California law affected only the timing of arbitration, and did not purport to prohibit arbitration altogether. Here, however, the Montana Supreme Court has interpreted *Volt* to permit a state to ban arbitration in its entirety, notwithstanding the existence of an arbitration agreement enforceable under the laws of the parties' own choosing. Nor does the justification offered by the Montana Supreme Court for its holding—that the FAA mandates the enforcement only of those

arbitration agreements that are "knowingly" entered into—survive scrutiny. Since the "knowing" requirement applies only to arbitration agreements and not to contracts generally in Montana, it is preempted under *Southland* and *Perry*. Behind Montana's preoccupation with ensuring that arbitration agreements are "knowingly" entered into lies considerable legislative and judicial hostility toward arbitration. Because of this apparent solicitude for arbitration of the majority of the Montana Supreme Court, when its decision and the statute it enforced are, in fact, based on hostility to arbitration agreements, and in order to forestall similar attempts by state courts or legislatures to use this Court's reasoning in *Volt* to turn the FAA on its head, it is critical that this Court grant review of that decision.

II.

THE MONTANA SUPREME COURT'S DECISION REPRESENTS UNSOUND PUBLIC POLICY

Arbitration notice provisions like Montana's not only run afoul of the Supremacy Clause and Section 2 of the FAA, but also represent unsound public policy based on a discredited judicial and legislative hostility to arbitration. Opponents of arbitration have long maintained that arbitration represents an inferior, and inadequate, form of justice compared with traditional litigation because, they say, it deprives parties of, among other things, substantive rights under state statutory and common law, the right to a jury trial, wide-ranging discovery procedures, a broad right of appeal, competent adjudicators and, in many cases, an in-state forum. Detractors of arbitration also attack the consensual nature of pre-dispute arbitration agreements, pointing out that those agreements are often contained in non-negotiated form contracts between parties of unequal bargaining power. These anti-arbitration sentiments, barely

concealed in the majority opinion of the Montana Supreme Court, come to the surface in the special concurring opinion of Justice Trieweiler. App. A at 18a-22a. This Court, however, has repeatedly dismissed those objections as unfounded[3] and, in doing so, has acknowledged the many benefits of arbitration, including speed, *see, e.g., Terminix*, 115 S. Ct. at 843; economy, *see, e.g., id.*; informality and adaptability of procedures; *see, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 633 (1985); availability of expert adjudicators, *see, e.g., Mitsubishi*, 473 U.S. at 633; and ability to preserve the disputants' relationship, *see Terminix*, 115 S. Ct. at 843. Moreover, as this Court has observed, arbitration offers advantages to large and small businesses as well as to individuals, notwithstanding that it is often invoked under a form contract between parties having unequal bargaining power. *See Terminix*, 115 S. Ct. at 843; *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1655 (1991).

Permitting the decision below, with its inherent bias against arbitration, to stand will encourage other state courts and legislatures to likewise impair the enforceability of arbitration agreements, with serious repercussions for franchising and other business relationships that utilize

---

[3] The various objections to arbitration which this Court has dismissed include: 1) its inability to further important social policies, *see Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1653 (1991); 2) inherent bias of arbitrators, *see id.* at 1654; *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 634 (1985); 3) lack of discovery procedures, *see Gilmer*, 111 S. Ct. at 1654-55; 4) lack of meaningful judicial review, *see Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 232 (1987); incompetence of arbitrators, *see McMahon*, 482 U.S. at 232; 6) limitations on substantive rights or relief, *see Gilmer*, 111 S. Ct. at 1655; and 7) that it is the product of unequal bargaining power, *Gilmer*, 111 S. Ct. at 1655.

arbitration to resolve disputes. Arbitration enjoys widespread use in the franchise community, in large part because it offers many advantages to franchisors and franchisees over traditional litigation. It is typically much less expensive than litigation because of the absence of, or limitations on, pleading requirements, motion practice, discovery and pretrial procedures. Since many disputes between franchisors and franchisees, such as claims for nonpayment of royalty fees, involve relatively small amounts of money, arbitration enables the parties to resolve these disputes economically without having to spend the entire value of the claim pursuing a remedy. Moreover, the great majority of franchisors are relatively small companies and, like many franchisees, cannot afford the high cost associated with pursuing or defending claims in a judicial forum.

The elimination or reduction in scope of motion practice, discovery and pretrial procedures in arbitration also makes it generally much quicker than litigation. The relative speed with which arbitrations proceed from the initial filing of the arbitration demand to the issuance of an award and, if necessary, confirmation of the award by a court, not only will in most cases cost the parties less in attorneys' fees but also will enable them to resume their relationship more quickly without the continuing disruptive influence of a pending lawsuit. Similarly, the informality and often less adversarial nature of arbitration enhance the prospect that the franchisor and franchisee will be able to honor their respective obligations while the arbitration is pending, put aside their differences once the arbitration has concluded and keep the franchise relationship intact. Franchise relationships are unique in today's business world because they typically run for a period of ten to twenty years. Since disputes are bound to arise in a relationship of that length, arbitration offers

a method for resolving those disputes while preserving the long-term nature of the relationship. Moreover, because arbitration is more flexible with regard to scheduling times and places of hearings, it tends to be less disruptive of the day-to-day operations of franchisors and franchisees alike, an important consideration in light of the fact that many franchisors and franchisees are small businesses with limited personnel. Finally, arbitration also offers the parties to a franchise relationship the option of having an individual experienced in franchising adjudicate their dispute. Because franchising is a unique form of business organization and is subject to a wide array of registration, disclosure and relationship laws, franchise expertise is often a sought-after qualification of arbitrators chosen to decide franchise disputes. To ensure that the many advantages of arbitration remain available to them, national franchisors should not be compelled to tailor their contract documents to meet the requirements of 50 different states.

Furthermore, there is nothing inherent in the arbitration process itself that favors franchisors over franchisees. Contrary to the anti-arbitration sentiments expressed in the special concurring opinion of Justice Trieweiler, franchisees are often sophisticated, multi-unit operators who, on their own behalf or through counsel, negotiate the terms of their franchise agreements, including whether and under what circumstances arbitration of disputes will occur. Although arbitration agreements often provide for arbitration in the franchisor's home state, there are sound business reasons for a franchisor to consolidate disputes with its franchisees in a forum where it can resolve them as cost-effectively as possible. It is certainly no more burdensome for an individual franchisee to arbitrate in the franchisor's home state than it is for a national franchisor to arbitrate against multiple franchisees in their

respective home states. Indeed, in light of this Court's decision in *Carnival Cruise Lines, Inc. v. Shute*, 111 S. Ct. 1522 (1991), upholding the enforceability of a non-negotiated choice-of-forum clause printed on the reverse side of a cruise line passenger ticket, there is no serious argument that forum selection clauses in the franchise relationship—a business relationship—are not fully enforceable.

Enforcement of arbitration agreements in the franchise relationship will also produce systemic benefits, economizing on the scarce judicial resources available for resolving other disputes where parties may not be able to structure a dispute resolution procedure in advance. Those scarce judicial resources are utilized not only when a dispute subject to arbitration is instead resolved in a judicial forum, but also when parties, encouraged by anti-arbitration decisions like that of the Montana Supreme Court in this case, participate in satellite litigation such as this to challenge the enforceability of agreements to arbitrate. The benefits that Congress sought to realize by mandating the rigorous enforcement of agreements to arbitrate will be realized only if state courts and state legislatures are reminded that attempts to undermine the enforceability of agreements to arbitrate will not go unnoticed by this Court. Otherwise, state legislatures will be unleashed to formulate all manner of requirements for, and obstacles to, arbitration agreements, and the sound public policy that underlies the FAA will be subverted. Moreover, there is no assurance that states will not seek to burden arbitration agreements retroactively, contending that the right to arbitrate is a purely procedural right, the deprivation of which would not impair obligations or substantive rights under franchise agreements. For those reasons, it is critical to the franchising community that this Court review the decision of the Montana Supreme Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JOHN F. VERHEY
Counsel of Record
LEWIS G. RUDNICK
RUDNICK & WOLFE
203 North LaSalle Street
Suite 1800
Chicago, Illinois 60601
(312) 368-4000

MATTHEW R. SHAY
THE INTERNATIONAL
FRANCHISE ASSOCIATION
1350 New York Avenue, N.W.
Suite 900
Washington, D.C. 20005
(202) 628-5000

Counsel for Amicus Curiae

Dated: May 8, 1995

Supreme Court, U.S.
FILED
MAY 15 1995
CLERK

(3)

No. 94-1518

In The

Supreme Court of the United States

October Term, 1994

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Petition For A Writ Of Certiorari To The Supreme Court Of Montana

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

GRANT D. PARKER
Counsel of Record
SARA J. JOHNSON
MULLENDORE, TAWNEY & WATT, P.C.
310 West Spruce Street
Missoula, MT 59802
(406) 542-5000

Counsel for Respondents

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTION PRESENTED

Whether, a state court may enforce state laws governing arbitration when the parties agree to apply state law, and when application of state law does not undermine the goals and policies of the Federal Arbitration Act. 9 U.S.C. § 1 *et seq.*

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

STATEMENT OF THE CASE 1

A. Factual Background 1

B. Decision Below 3

REASONS FOR DENYING THE WRIT 5

I. THE MONTANA SUPREME COURT PROPERLY APPLIED STATE LAW, WHICH DOES NOT UNDERMINE THE GOALS AND POLICIES OF THE FAA, TO A CONTRACT WHICH SELECTED STATE LAW 5

II. THE DECISION OF THE MONTANA SUPREME COURT IS IN CONCERT WITH EXISTING CASELAW 7

III. THE MONTANA SUPREME COURT DECISION IS NOT A GOOD VEHICLE FOR ADDRESSING THE CONCERNS RAISED BY PETITIONERS 11

CONCLUSION 14

TABLE OF AUTHORITIES

Page

CASES:

Allied-Bruce Terminix Companies, Inc. v. Dobson, 115 S.Ct. 834 (1995) 12, 13

American Airlines, Inc. v. Wolens, 115 S.Ct. 817 (1995) 10

Bunge Corp. v. Perryville Feed & Produce, Inc., 685 S.W.2d 837 (Mo. 1985) 7, 8

Chor v. Piper, Jaffray & Hopwood, Inc., 862 P.2d 26 (Mont. 1993) 12

David L. Threlkeld & Co. v. Metallgesellschaft Ltd., 923 F.2d 245 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991) 9

Downey v. Christensen, 825 P.2d 557 (Mont. 1992) 12

Edenfield v. Fane, 113 S.Ct. 1792 (1993) 10

Home Buyers Warranty Corp. II v. Lopez, 115 S.Ct. 930 (1995) 12

Larsen v. Opie, 771 P.2d 977 (Mont. 1989) 12

Mastrobuono v. Shearson Lehman Hutton, 115 S.Ct. 1212 (1995) 5, 7

Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) 9, 13

Moses H. Cone Memorial Hospital v. Mercury Construction Co., 460 U.S. 1 (1983) 13

Passage v. Prudential-Bache Securities, 727 P.2d 1298 (Mont. 1986), *cert. denied*, 480 U.S. 905 (1987) 12

Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) 13

TABLE OF AUTHORITIES – Continued

Page

Securities Industry Ass'n v. Connolly, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990) . . 9, 10

Snap-On Tools v. Vetter, 838 F. Supp. 468 (D. Mont. 1993) 9

So. Health Corp. of Hamilton, Inc. v. Lorance, 115 S.Ct. 930 (1995) 12

Terminix Int'l Ltd. P'ship v. Jackson, 115 S.Ct. 930 (1995) 12

Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468 (1989) . . . . . *passim*

Vukasin v. D.A. Davidson & Co., 785 P.2d 713 (Mont. 1990) 12

Webb v. R. Rowland & Co., 800 F.2d 803 (8th Cir. 1986) 7

William Gibson, Jr. v. James Graff Communications, Inc., 780 P.2d 1131 (Mont. 1989) 12

STATUTES:

9 U.S.C. § 1 *et seq.* . . . . . *passim*

9 U.S.C. § 2 . . . . . 4, 6

9 U.S.C. § 3 2

9 U.S.C. § 202 9

Mont. Code Ann. § 27-5-114(4) (1993) 4

No. 94-1518

In The

Supreme Court of the United States

October Term, 1994

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,

Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,

Respondents.

On Petition For A Writ Of Certiorari To The Supreme Court Of Montana

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Respondents Paul and Pamela Casarotto respectfully request that this Court deny the petition for writ of certiorari, seeking review of the Montana Supreme Court's opinion in this case. That opinion is reported at 886 P.2d 931 (1994).

STATEMENT OF THE CASE

A. Factual Background

Respondents Paul and Pamela Casarotto brought an action in Montana district court to recover damages for

various tort and contract claims against Petitioners Doctor's Associates, Inc. ("DAI"), and Nick Lombardi ("Lombardi"), DAI's Montana Development Agent. Pet. App. 2a. DAI is a Connecticut corporation which franchises Subway Sandwich Shops nationally and internationally. Pet. App. 2a. Lombardi is an independent contractor who serves as DAI's Montana Development Agent. Pet. App. 2a.[1]

Pursuant to 9 U.S.C. § 3, the Montana district court granted Petitioners' motion to stay the lawsuit as against DAI and Lombardi pending arbitration. Pet. App. 5a. The Montana Supreme Court reversed. Pet. App. 17a.

For the purposes of its review, the Montana Supreme Court presumed the following facts alleged in the complaint were true. Pet. App. 2a. The Casarottos entered into a Franchise Agreement with DAI which allowed Casarottos to open a Subway Sandwich Shop in Great Falls, Montana. Pet. App. 2a-3a. Lombardi informed Casarottos that their preferred location in Great Falls was

---

[1] Even though Mr. Lombardi was not a signatory to the arbitration agreement, he has tried to bootstrap onto DAI's arguments, and appears to claim that he is entitled to arbitration based on a franchise agreement to which he is not a party. DAI carefully avoids confirming or denying whether it considers its independent contractor Lombardi an agent. Pet. 4-5, n.4; Appellees' Response Brief at 7-8, 21-22, 26, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994). Franchisor's own circulars attempt to avoid any agency relationship and describe Lombardi and other "Development Agents" as *independent contractors*. DAI's Franchise Offering Circular for Prospective Franchisees as Required by the Federal Trade Commission ("Franchise Offering Circular"), Appendix to brief for the Appellants, Exhibit 2, at 9, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994).

unavailable. Pet. App. 3a. Casarottos agreed to open a shop at a less desirable location based upon a verbal agreement with Lombardi reserving for Casarottos the exclusive right to open a Subway shop in the preferred location when it became available. Pet. App. 3a. Contrary to that agreement, Lombardi and DAI subsequently awarded the preferred location to another franchisee. Pet. App. 3a. As a result, Casarottos' shop suffered irreparably and they lost their business and the collateral securing their SBA loan. Pet. App. 3a.

Page nine of DAI's standard Franchise Agreement contains an arbitration clause which calls for arbitration of claims in Bridgeport, Connecticut. Pet. App. 3a-4a. The full text of the arbitration clause is set forth at Pet. App. 3a-4a, n.2. The Franchise Agreement calls for the application of state law, and designated Connecticut law. Pet. App. 4a.

B. Decision Below

Applying established conflict-of-law principles, the Montana Supreme Court held that Montana law governed the franchise agreement entered into between Casarottos and DAI. Pet. App. 5a-10a.[2] The Montana court determined that Montana had a materially greater interest than Connecticut in a contract negotiated in Montana, to be performed in Montana, the subject matter of

---

[2] Because the Montana Supreme Court reversed the district court, it did not reach the issue as to whether the arbitration agreement in DAI's contract would extend to its independent contractor, Nick Lombardi.

which was a sandwich shop in Montana, and entered into between Montana residents and a Connecticut corporation. Pet. App. 8a. The Montana court then found the contractual provision selecting Connecticut law was not effective because it violates fundamental public policy in Montana, the state with the materially greater interest. Pet. App. 8a-10a.

Petitioners do not challenge the Montana court's application of standard conflict-of-law principles to hold that Montana law applied. What Petitioners challenge is the result of applying Montana law, and more particularly, Montana's statutory notice requirements at Mont. Code Ann. § 27-5-114(4) (1993). Pet. App. (i).

The challenged decision addressed whether Montana's notice requirement is preempted by Section 2 of the Federal Arbitration Act (FAA) (9 U.S.C. § 1 *et seq.*). Pet. App. 10a-17a. Relying on this Court's analysis in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), and standard preemption analysis, the Montana court found it was not. Pet. App. 16a. Montana's notice statute is not preempted by Section 2 of the (FAA) because it does not undermine the goals and policy of the FAA. Pet. App. 16a-17a. Because Petitioner DAI's agreement did not comply with Montana's statutory notice requirements, the agreement is not subject to arbitration according to Montana law. Pet. App. 17a.

REASONS FOR DENYING THE WRIT

The Petition should be denied because it does not raise issues that warrant review by this Court. The Montana Supreme Court decision was based on a permissible state court application of state law to a contract in which the parties agreed to abide by state law. This Court will not question a state court's interpretation of state law when parties agree to apply state law in an arbitration agreement. *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 474 (1989); *accord Mastrobuono v. Shearson Lehman Hutton*, 115 S.Ct. 1212, 1217 n.4 (1995).

Contrary to Petitioners' protestations, the decision below is consistent with this Court's holding in *Volt*, 489 U.S. 468. Further, the decision below does not conflict with caselaw from the Circuits or that of other states. Since the Supreme Court's ruling in *Volt*, no Federal Circuit court or state court of last resort (except Montana) has addressed the applicability of the FAA to state law notice requirements when the parties agreed to apply state law. This question has not received the degree of judicial scrutiny which would warrant issuance of a writ of certiorari.

I. THE MONTANA SUPREME COURT PROPERLY APPLIED STATE LAW, WHICH DOES NOT UNDERMINE THE GOALS AND POLICIES OF THE FAA, TO A CONTRACT WHICH SELECTED STATE LAW.

The Montana court's decision is narrowly drawn to apply state law in a contract selecting state law, and is

consistent with *Volt*. The parties to the arbitration agreement expressly agreed to apply state law. Pet. App. 5a. The Montana Supreme Court undertook a thorough conflict-of-law analysis, applying standard conflict-of-law principles in reaching its decision to apply Montana law. Pet. App. 5a-10a. Petitioners do not challenge the Montana Supreme Court's application of Montana law and choice of law analysis, instead requesting review solely on the question of whether Section 2 of the FAA preempts Montana's notice requirement. Pet. App. (i)

The Montana Supreme Court relied on this Court's decision in *Volt* to find that the FAA did not preempt Montana's notice requirement. The Montana Supreme Court stated:

> Our conclusion that Montana's notice requirement does not undermine the policies of the FAA is based on the Supreme Court's conclusion that its was never Congress's intent when it enacted the FAA to preempt the entire field of arbitration, and its further conclusion that the FAA does not require parties to arbitrate when they have not agreed to do so. The Court held that the purpose of the FAA is simply to enforce arbitration agreements into which parties had entered, and acknowledge that the interpretation of contracts is ordinarily a question of state law.

Pet. App. 16a; *citing Volt*, 489 U.S. at 474.

The Montana Supreme Court decision was based on a permissible state court application of standard conflict-of-law principles to a contract in which the parties agreed to abide by state law. This Court has indicated that it will

not set aside a state court's interpretation of state law when parties agree to apply state law. *Volt*, 489 U.S. at 474; *accord Mastrobuono*, 115 S.Ct. 1212, 1217 n.4 (1995). This Court will allow parties in arbitration agreements to choose to apply state law. *Mastrobuono*, 115 S.Ct. at 1217. Thus, this Court does not sit to review the matters of state law addressed by the Montana Supreme Court.

II. THE DECISION OF THE MONTANA SUPREME COURT IS IN CONCERT WITH EXISTING CASE-LAW.

In attempting to demonstrate a conflict, Petitioners mischaracterize the holding of the Montana Supreme Court and other cited decisions. In fact, the authorities which Petitioners rely on are readily distinguished from the instant proceeding because they i) do not include the pre-emption analysis in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), or ii) fail to contain contractual provisions which select state law. In the contract drafted by franchisor DAI the parties agreed to be governed by state law. DAI's arguments fail because they do not address cases where parties contractually agreed to subject themselves to state law. The authority relied on by DAI is inapposite.

Cases cited by DAI in attempting to demonstrate a conflict include two cases decided before *Volt*, *Webb v. R. Rowland & Co.*, 800 F.2d 803 (8th Cir. 1986) and *Bunge Corp. v. Perryville Feed & Produce, Inc.*, 685 S.W.2d 837 (Mo. 1985). In *Webb* the Eighth Circuit applied a pre-*Volt* analysis to a contract which invoked Missouri law. 800 F.2d at 806. *Volt*, as cited by the Montana court, clarifies that

when the parties have agreed to be bound by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA.[3] Pet. App. 14a. Applying this Court's preemption analysis, as clarified in *Volt*, the Eighth Circuit should reach a different decision regarding the application of the Missouri statute. DAI's attempt to portray a conflict based on pre-*Volt* cases which have lost their authority in light of the Supreme Court's intervening decision in *Volt* should fail.

Similarly, in *Bunge Corp.*, a decision four years before *Volt*, the Missouri Supreme Court found a contractual dispute subject to the rules and regulations of the National Grain and Feed Association was subject to arbitration. 685 S.W.2d at 838. While the Missouri court acknowledged that Missouri's statutory notice requirements could not be applied to undermine the FAA, the court refrained from invalidating Missouri's statute, stating, "[w]e do not have to decide, and we do not decide, whether an arbitration agreement *governed by Missouri law* is unenforceable in all events. . . . " *Id.*, at 839. Emphasis supplied. Thus the Missouri court, foreshadowing this Court's decision in *Volt*, expressly sidestepped the decision addressed squarely by the Montana Supreme Court.

---

[3] Petitioners argue that the Montana court erroneously interpreted *Volt* as limiting preemption of state law to those instances in which the state law "undermines the goals and policy of the FAA." Pet. App. 14. Ironically, the Montana Supreme Court quoted the offending phrase (Pet. App. 14a) directly from *Volt*. 489 U.S. at 477-78.

Furthermore, the decision of the Montana Supreme Court addressed a distinct issue from those cases in which parties did not invoke state law. In *David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 247 and 250 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991), the parties agreed to arbitration in accordance with the rules and regulations of the London Metals Exchange. Accordingly, the Second Circuit applied the international Convention (9 U.S.C. § 202) as a specific unit of the FAA.[4] Similarly, where parties agreed to be bound by the FAA, with no selection of state law, the federal district court applied those rules. *Snap-On Tools v. Vetter*, 838 F. Supp. 468 (D. Mont. 1993). These decisions, enforcing contracts according to those rules by which the parties agreed to be bound, are in accord with the Montana Supreme Court decision in the instant case.

Similarly, the First Circuit's decision in *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990), gave no consideration to the ability of parties to apply state law through a choice-of-law provision. In that case, the First Circuit found that the FAA preempted Massachusetts regulations concerning predispute arbitration agreements for securities brokers. No consideration was made of the ability of the

---

[4] Unlike the current case, the decision in *Threlkeld* involved international commerce, an area in which the policy favoring arbitration is "even stronger" and "applies with special force." *Threlkeld*, 923 F.2d 248, *citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). Additionally, *Threlkeld* applied Section 202 of the FAA, 9 U.S.C. § 202, rather than Section 2, at issue in this case.

parties to invoke state law through a choice-of-law provision. *Connolly* addresses a distinct issue from that presented in this case where franchisor invoked state law by the terms of its own Franchise Agreement.

The Montana decision is squarely consistent with *Volt*, and does not directly conflict with any decision of this Court, nor of any court of appeals. There is no split in the circuits nor an intolerable conflict between the highest state courts.

Moreover, and without conceding the point, even if one were inclined towards the view that the Montana Supreme Court's decision conflicts with rulings by other courts, the "conflict" Petitioners allege is plainly tolerable at this time. Try as Petitioners might, they could only identify two post-*Volt* cases, in addition to this case, from state supreme courts or federal appellate courts in which the validity of state notice requirements has been litigated. This proceeding is the only one in which the parties selected state law. Significantly, there is no conflict between the decision below and any ruling of the Ninth Circuit, such that a different result might obtain depending upon whether a claim arising in Montana was filed in Montana state court or federal court. *Compare American Airlines, Inc. v. Wolens*, 115 S.Ct. 817 (1995), and *Edenfield v. Fane*, 113 S.Ct. 1792 (1993) (granting review in cases where state and federal courts reached opposite conclusions).

If anything, the weakness in Petitioners' line of attack is illustrated by their reliance, at least in part, on dire predictions about what state legislatures and other courts might do if this lone decision from the Montana Supreme

Court is allowed to stand (Pet. 20-23), a tacit concession that the legal issue they raise has not yet matured to the point that review by this Court is appropriate at this time. Thus, when all is said and done, Petitioners' real quarrel with the decision below is the fact that they lost. That is not sufficient reason for this Court to grant review.

III. THE MONTANA SUPREME COURT DECISION IS NOT A GOOD VEHICLE FOR ADDRESSING THE CONCERNS RAISED BY PETITIONERS.

The Petitioners attempt to portray the Montana decision as one of national importance. Pet. 20-23. However, Montana is the only state to hold that the state notice provision is applicable when parties select state law in their contract, and no federal circuit court has ruled on this particular issue after *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989).[5] Should the states rise and follow Montana's lead regarding the pre-emptive scope of the FAA, as Petitioners predict (Pet. at 23), actual conflicts may appear and the issue will then be more appropriate for this Court's review. Those cases may provide a more germane vehicle, strictly limited to signatories to a contract, rather than including the development agent/independent contractor of one of the parties seeking protection of the arbitration provisions.

---

[5] As of May 11, 1995, no other court has cited *Casarotto*, despite the plethora of arbitration litigation.

Nor is the challenged case from a state supreme court which has demonstrated consistent hostility toward arbitration.[6] As Petitioners readily conceded below, the Montana Supreme Court, "has consistently upheld the federal policy in favor of arbitration and applied the FAA to arbitration clauses in contracts involving interstate commerce." Brief for the Appellees Nick Lombardi and Doctor's Associates, Inc., at 9, *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994). The Montana Supreme Court's decisions have repeatedly upheld the validity of arbitration agreements.[7] In light of their own concessions below,

---

[6] *Cf. Allied-Bruce Terminix Companies, Inc. v. Dobson*, 115 S.Ct. 834 (1995) (granting review and concurrently vacating and remanding the following additional Alabama Supreme Court decisions for further consideration in light of its decision: *Home Buyers Warranty Corp. II v. Lopez*, 115 S.Ct. 930 (1995); *Terminix Int'l Ltd. P'ship v. Jackson*, 115 S.Ct. 930 (1995); and *So. Health Corp. of Hamilton, Inc. v. Lorance*, 115 S.Ct. 930 (1995)).

[7] *See, e.g., Chor v. Piper, Jaffray & Hopwood, Inc.*, 862 P.2d 26 (Mont. 1993) (finding contracts requiring arbitration are as enforceable in Montana as any other contracts); *Downey v. Christensen*, 825 P.2d 557 (Mont. 1992) (holding franchisor's participation in discovery did not waive right to compel arbitration); *Vukasin v. D.A. Davidson & Co.*, 785 P.2d 713 (Mont. 1990) (finding arbitration clause in annual review document an enforceable part of employment agreement); *William Gibson, Jr. v. James Graff Communications, Inc.*, 780 P.2d 1131 (Mont. 1989) (finding contract involving interstate commerce subject to the FAA); *Larsen v. Opie*, 771 P.2d 977 (Mont. 1989) (holding claim of fraud in the inducement of the execution of a contract containing an arbitration clause is to be decided by arbitration); *Passage v. Prudential-Bache Securities*, 727 P.2d 1298 (Mont. 1986), *cert. denied*, 480 U.S. 905 (1987) (holding parties subject to arbitration even if customer agreement at issue was found to be a contract of adhesion).

Petitioners' assertions of the Montana Supreme Court's hostility toward arbitration (Pet. 12-13) ring hollow.

This Court has consistently held that the FAA only places arbitration agreements on the same footing as other contracts, but does not make super contracts out of such agreements.[8] Companies such as Petitioner DAI routinely draft the contracts in question, and certainly can make their own choice whether to select state law.

---

[8] *Allied-Bruce Terminix Companies, Inc.*, 115 S.Ct. at 840; *Volt*, 489 U.S. at 474-75 (stating the FAA does not give parties powers in excess of any other contract clause); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (recognizing a party may exclude certain claims from the scope of their arbitration agreement); *Moses H. Cone Memorial Hospital v. Mercury Construction Co.*, 460 U.S. 1 (1983) (finding the FAA puts arbitration clauses on the same footing as other contracts and reflecting a general federal policy favoring arbitration); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (holding the Federal Arbitration Act makes arbitration agreements "as enforceable as other contracts, but not more so").

CONCLUSION

For the reasons set forth above, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

GRANT D. PARKER
Counsel of Record

SARA J. JOHNSON
MULLENDORE, TAWNEY & WATT, P.C.
310 West Spruce
Missoula, Montana 59802
(406) 542-5000

Counsel for Respondents

Dated May 15, 1995

Supreme Court, U.S.
FILED
MAY 19 1995
CLERK

No. 94-1518

IN THE
Supreme Court of the United States
OCTOBER TERM, 1994

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,
Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,
Respondents.

Petition for a Writ of Certiorari to the Supreme Court of Montana

---

REPLY BRIEF FOR PETITIONERS

MARK R. KRAVITZ *
JEFFREY R. BABBIN
WIGGIN & DANA
One Century Tower
P.O. Box 1832
New Haven, CT 06508-1832
(203) 498-4400

H. BARTOW FARR, III
FARR & TARANTO
2445 M Street, N.W.
Washington, D.C. 20037
(202) 775-0184

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
I. THE MONTANA NOTICE STATUTE IS PREEMPTED BY THE FEDERAL ARBITRATION ACT	1
II. THIS CASE IS APPROPRIATE FOR REVIEW	5
CONCLUSION	7

TABLE OF AUTHORITIES

CASES — Page

Allied-Bruce Terminix Companies v. Dobson, 115 S. Ct. 834 (1995) 4, 7

David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London), 923 F.2d 245 (2d Cir.), cert. dismissed, 501 U.S. 1267 (1991) 5

Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S. Ct. 1212 (1995) 3, 5

Moses H. Cone Memorial Hosp. v. Mercury Constr. Co., 460 U.S. 1 (1983) 4

Perry v. Thomas, 482 U.S. 483 (1987) 4

Securities Industry Ass'n v. Connolly, 883 F.2d (1990) 5

1114 (1st Cir. 1989), cert. denied, 495 U.S. 956

Southland Corp. v. Keating, 465 U.S. 1 (1984) 4

Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University, 489 U.S. 468 (1989) 2, 3, 4

STATUTES

9 U.S.C. § 2 1

Conn. Gen. Stat. § 52-408 (1995) 2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

No. 94-1518

DOCTOR'S ASSOCIATES, INC. and NICK LOMBARDI,
Petitioners,

v.

PAUL CASAROTTO and PAMELA CASAROTTO,
Respondents.

Petition for a Writ of Certiorari to the Supreme Court of Montana

---

REPLY BRIEF FOR PETITIONERS

I. THE MONTANA NOTICE STATUTE IS PREEMPTED BY THE FEDERAL ARBITRATION ACT.

Respondents do not dispute either of the two points that are essential to answering the question presented by the petition. One, the parties entered into a written agreement to arbitrate involving interstate commerce that met all of the requirements of Section 2 of the Federal Arbitration Act ("FAA"), which makes written agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Two, the Montana Supreme Court refused to enforce the agreement to arbitrate on the ground that the agreement did not comply with a notice requirement under Montana law that is applicable only to arbitration agreements and not to other types of agreements. Under the plain and un-

equivocal language of Section 2 and the decisions of this Court, those two points alone are sufficient to find preemption of the Montana notice statute. *See* Pet. 10-14.

Respondents also make no effort to justify the Montana Supreme Court's decision on the basis of the rationale relied upon by that court. Instead, respondents' brief in opposition makes just one argument why the Montana notice statute is not preempted by Section 2. According to respondents, the parties "expressly agreed to apply state law" to their franchise agreement. Br. in Opp. 6. Therefore, according to respondents, the Montana Supreme Court's decision not to enforce the agreement to arbitrate on the basis of Montana law was appropriate under *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989), because the decision below was based on "a state court's interpretation of state law when "parties [have] agree[d] to apply state law." Br. in Opp. 6-7.

There are, however, several obvious problems with respondents' argument. First, the parties did not agree to apply just any "state law" to their agreement; the choice-of-law clause in the franchise agreement expressly provided that the agreement "shall be governed by and construed in accordance with the laws of the State of Connecticut." Pet. App. 5a. Respondents do not dispute that Connecticut law has no notice requirement comparable to Montana's. Thus, it is undisputed that the parties' agreement to arbitrate is enforceable under the state law chosen by the parties. *See* Conn. Gen. Stat. § 52-408 (1995).

Second, the Montana Supreme Court did not base its decision on a finding that the parties *intended* to apply Montana law to their agreement; nor could it have done so given the parties' unambiguous choice of Connecticut law. Instead, the Montana Supreme Court refused to apply the law chosen by the parties, because to do so "would be contrary to a fundamental policy of this State

by eliminating the requirement that notice be provided when a contract is subject to arbitration." Pet. App. 8a-9a.[1]

Third, therefore, respondents' reliance on *Volt* simply does not hold up. Unlike the situation in *Volt* where the state court applied the law chosen by the parties in their contract, the court in this case did just the opposite: it *refused* to enforce the state law that the parties had selected in their contract. Indeed, the court below very clearly distinguished this case from *Volt* by stating as follows: "While the Court in *Volt* applied state laws that had been chosen by the parties in their contract, . . . this case involves state law which is applied pursuant to conflict of law principles . . . ." Pet. App. 15a. Because the parties here did not choose Montana law, it can hardly be said that applying Montana law to invalidate the parties' agreement to arbitrate enforces the intent of the parties, which was the rationale for the decision in *Volt*. *See Volt*, 489 U.S. at 478; *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1216 (1995). And, because respondents' argument begins and ends with the decidedly false assumption that the parties here in-

---

[1] Although respondents say that "[p]etitioners do not challenge the Montana court's application of standard conflict-of-law principles to hold that Montana law applied," Br. in Opp. 4, that representation is incorrect. As we pointed out in the petition, the Montana Supreme Court "ma[d]e a second, related error," Pet. 12 n.8, by relying on a state policy hostile to arbitration as the reason for applying Montana law to the agreement under conflict-of-law principles and then proceeding to invalidate the agreement under that same policy. If it were not for the notice requirement that petitioners argue is preempted by Section 2, the court below would not have reached its conclusion that the Connecticut law chosen by the parties was offensive to Montana's public policy. *See* Pet. App. 9a-10a. In any event, because the Montana statute is preempted by Section 2, it is not necessary for the Court to reach out and decide whether Montana's conflict-of-laws analysis was independently flawed by its dependence on a statute evidencing hostility toward arbitration.

tended the Montana notice statute to govern their relationship—an assumption not even indulged in by the Montana Supreme Court—they are left with no defense of the decision below.

What the Montana Supreme Court did decide is that Montana law, even when *not* chosen by the parties (and, more particularly, even when the parties had chosen a different state's law), could invalidate an agreement to arbitrate despite the fact that the Montana law was arbitration-specific and did not govern contracts generally. The sole basis of that decision was a misreading of *Volt* that the preemptive scope of Section 2 is limited to laws that "undermine the goals and policies of the FAA" and that the notice statute does not fall within that category. Pet. App. 15a. That misreading of *Volt* has already been thoroughly addressed in the petition,[2] and respondents have said nothing to question petitioners' analysis that state laws conditioning enforcement of arbitration agreements on compliance with particular state requirements are preempted unless they apply to contract provisions generally, and not just to arbitration provisions. *See Terminix*, 115 S. Ct. at 838-39, 843; *Perry v. Thomas*, 482 U.S. 483, 489-91 & 492 n.9 (1987); *Southland Corp. v. Keating*, 465 U.S. 1, 10-16 (1984); *Moses H. Cone*

---

[2] Briefly, *Volt* did not address whether an arbitration agreement should be enforced; it dealt only with whether a state law governing the timing of arbitration could be enforced by a state court when the parties had chosen that law to govern their agreement, and where the state law fostered the federal policy favoring arbitration by addressing a practical problem that the FAA failed to address. *See* 489 U.S. at 476 n.5, 478. It is still the case that Section 2 preempts state laws that place arbitration agreements on an unequal footing with other contracts, as such laws are "*directly* contrary to the Act's language and Congress's intent." *Allied-Bruce Terminix Companies v. Dobson*, 115 S. Ct. 834, 843 (1995) (emphasis added). Respondents do not take issue with petitioners' analysis of the Montana notice statute as placing arbitration agreements on a different footing from other contracts.

Memorial Hosp. v. Mercury Constr. Co., 460 U.S. 1, 24 (1983).[3]

II. THIS CASE IS APPROPRIATE FOR REVIEW.

Respondents attempt to minimize the conflict between the decision below and the decisions of the U.S. Courts of Appeals for the First, Second and Eighth Circuits and the Missouri Supreme Court. They do so principally on the ground that the parties here "agreed to be governed by state law" but that the parties in the cases cited by petitioners did not so agree. *See* Br. in Opp. 7-10. Because, as we have discussed, the parties did *not* agree to be bound by the Montana notice statute relied on by the court below, respondents' effort to distinguish the contrary authority falls of its own weight. Moreover, as explained in the petition, both the Second and First Circuits found preemption of notice provisions *after Volt*, with the latter expressly distinguishing *Volt* in finding preemption under Section 2. *See David L. Threlkeld & Co. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 249-50 (2d Cir.), *cert. dismissed*, 501 U.S. 1267 (1991); *Securi-*

---

[3] Under the recent decision in *Mastrobuono*, Montana's notice statute would be preempted even if, hypothetically, the parties *had* agreed to let Montana law govern their franchise agreement. In *Mastrobuono*, the Court characterized a choice-of-law provision similar to the one here as merely serving as "a substitute for the conflict-of-laws analysis that otherwise would determine what law to apply to disputes arising out of the contractual relationship." 115 S. Ct. at 1217. The Court found "untenable" an interpretation of the choice-of-law clause that would put the clause in conflict with the contract's arbitration clause. *Id.* at 1219. It would be even more absurd, and in conflict with the federal policy favoring arbitration and construing ambiguities in favor of arbitration (*see id.* at 1218 & n.8), to rule on the basis of a choice-of-law clause that the parties agreed to an arbitration clause in their franchise agreement at the same time as they agreed that the arbitration clause was invalid for failure to include the prescribed notice on the first page of the agreement. Certainly, *Volt* does not dictate such a bizarre result.

ties Indus. Ass'n v. Connolly, 883 F.2d 1114, 1119 n.3 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990).

Thus, the conflict between the courts below is real and substantial. Moreover, the issue is of considerable importance. If the decision of the Montana Supreme Court is allowed to stand, other jurisdictions hostile to arbitration may feel free to follow Montana's erroneous interpretation and application of *Volt* and refuse to enforce arbitration agreements on the basis of state-law requirements that are not applicable to contracts generally. Such a result would inevitably disrupt the national uniformity that Congress sought to achieve in enacting the FAA.[4]

Respondents further contend that review by this Court is unnecessary because the Montana Supreme Court has not demonstrated "consistent hostility" toward arbitration. Br. in Opp. 12. While respondents are careful not to describe the decision below as lacking hostility toward arbitration, it is ultimately the case that this Court does not sit in review of a lower court's attitudes. Respondents' contention is therefore irrelevant to the decision whether to grant the petition. The real issue here is the notice statute. According to the court below, the notice statute embodies Montana public policy that is suspicious of arbitration as inconvenient, expensive and devoid of the pro-

[4] Respondents also argue that this case is an inappropriate vehicle for reaching the issue presented in the petition because petitioner Nick Lombardi was not a party to the agreement to arbitrate. Br. in Opp. 2 n.1, 11. The Montana trial court, however, ruled that the claims against Lombardi were encompassed by the arbitration agreement and that the claims against Lombardi should be stayed pending arbitration. Pet. App. 40a. The Montana Supreme Court did not reach that specific issue. *See* Pet. App. 5a. This Court can therefore decide the issue presented in the petition without concerning itself with whether the Montana trial court erred by staying the claims against Lombardi. That issue can be raised by respondents on remand if still appropriate. In any event, respondents' arguments regarding Lombardi have no bearing on the petition of Doctor's Associates, Inc.

cedural safeguards of a judicial proceeding. Pet. App. 9a-10a. The notice statute places agreements to arbitrate on a different footing from other agreements, and for that reason may not be applied to agreements to arbitrate that, like the one here, meet all of the requirements for enforceability under the FAA. *See Terminix*, 115 S. Ct. at 838.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

MARK R. KRAVITZ *
JEFFREY R. BABBIN
WIGGIN & DANA
One Century Tower
P.O. Box 1832
New Haven, CT 06508-1832
(203) 498-4400

H. BARTOW FARR, III
FARR & TARANTO
2445 M Street, N.W.
Washington, D.C. 20037
(202) 775-0184

* Counsel of Record

Dated: May 19, 1995